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Giving Undertaking or Deficiency Agreements to Lenders/Creditors: Mere Words or Are they Much More?

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In a recent Ontario Court of Appeal decision *(Global Food Traders Inc. v. Massalin* (2015 O.J. No. 2577) the issue before the Court was as follows:

Fernando Massalin ("Massalin") was the sole officer, director and controlling mind of the corporate defendant Latinamerican Foods Inc. "(LAFI"). Global Food Traders Inc. ("Global") had entered into a contract with LAFI to sell its trademarks and customer lists to LAFI for $500,000, payable in 50 equal monthly payments of $10,000 by post-dated cheques.

The defendant Massalin executed the Sale Agreement ("Agreement") on behalf of the purchaser LAFI.

A term of the Agreement contemplated Massalin providing funds to cover any post-dated cheques that were returned "NSF". Payments totalling $140,000 were made by LAFI when due, after which time, the balance went into default. Ultimately LAFI was placed into receivership.

Section 1 of the Agreement stated:

> "The Purchase Price shall be payable in 50 equal monthly instalments of $10,000, commencing April 30, 2012 by post-dated cheques. *If Mr. Massalin's obligations are called upon pursuant to this Section, he shall within three days provide the Seller immediately with available funds to cover any bounced or NSF cheques*" [italics added]

Below the execution line on the Sale Agreement, where each of the Vendor/Purchaser signed, was the following statement:

> "The undersigned is executing this Agreement solely in connection with his obligations set forth in Section 1 of this Agreement"

Massalin, in his personal capacity, signed on the line below the above statement.

Massalin was sued personally for the outstanding debt remaining

outstanding and the trial judge held he was liable to pay on the basis of the above wording.

Massalin appealed and submitted to the Court of Appeal that:

1. the motion judge gave no reason for the decision (Court of Appeal didn't agree);
2. the decision is flawed because the motion judge failed to make a finding of liability against LAFI (Court of Appeal didn't agree); and
3. the motion judge erred in finding that Section 1 of the Agreement (set out above) constituted a guarantee.

The Court of Appeal stated that while the word "guarantee" is not used in Section 1, it is clear from that section and underscored at the foot of the Agreement (signature of Massalin) that Section 1 contains Massalin's personal guarantee of LAFI's payment obligation under the Agreement.

The Court of Appeal went on to note that while Massalin disputed the wording was a guarantee, he offered no other plausible explanation for what meaning could be given to the last sentence of Section 1, or why else he signed the Agreement in his personal capacity (having already signed on behalf of LAFI).

The Court of Appeal felt that while there was a lack of precision in the wording of Section 1, there could be no misapprehension as to what the parties were agreeing to when they executed the Agreement and held Massalin, the sole officer, director and controlling mind of LAFI, was providing his personal guarantee to pay any amounts required to cover LAFI's "bounced" or "NSF" cheques.

This case once again underlies that a guarantee need not be called "guarantee" to be enforceable and the Court will look to the full agreement and surrounding facts to determine what the wording stands for.

Cash Flow Deficiency Undertakings

This case leads one to consider its application in other loan scenarios. When a lender to a corporate borrower asks the principal (or group of shareholders as the case may be) to execute a cash flow deficiency undertaking, it is seeking to obtain their personal undertaking to cover off any cash flow deficiencies the corporate borrower may incur. Once that undertaking is executed, the shareholder(s) could be met with the same questions of why else was it being signed if not to commit to personally cover the deficiencies.

Counsel should be aware of this concern, and if the principal is also granting a limited guarantee, reference should be made in the deficiency agreement (or letter agreement) to the effect that the deficiency agreement terms are included in the liability amount of the limited guarantee given, and any payment under the limited guarantee shall be appropriately credited against the deficiency agreement (or letter agreement) obligation. In addition, the letter of undertaking or deficiency agreement should state it is given in conjunction with the limited guarantee.

The deficiency undertaking should clearly state the undertaking in the deficiency undertaking is limited to the amount contained in any guarantee given by the signatory, and that any recovery under either is deemed recovery under both.

I am not sure that many shareholders give thought to the fact there could be a claim against them on a deficiency undertaking and the fact it doesn't say it is a guarantee may be part of the reason this is so.

In addition, in many instances, the shareholder(s) asked to execute the undertaking treats it like a "banking document" and doesn't think to have a lawyer review it prior to execution.

As in the Global case, counsel may well be met with the Court saying while it doesn't say "guarantee", what other reasonable explanation for asking for and receiving it exists if signed personally by a shareholder.

While facts will vary in each case, one must carefully review wording in a deficiency undertaking provided to a shareholder by a lender, especially if there is either (i) no personal guarantee per se; or (ii) the guarantee is for a limited amount, as the deficiency undertaking could give rise to a claim of it being a personal guarantee, albeit not specifically so named, and thus raising the liability exposure of the signatory.