



When Does the Limitation Period Begin to Run on Guarantees?:

The Bank of Nova Scotia v. Williamson

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The Limitations Act, 2002

The *Limitations Act, 2002* (Ontario) (the “Act”) came into force and effect on January 1, 2004. The Act provides a basic two-year limitation period that commences on the day on which a “claim to remedy an injury, loss or damage that occurs as a result of an act or omission” is discovered. The Act was amended by Bill 114, the *Budget Measures and Interim Appropriation Act, 2008*, which received royal assent on November 27, 2008. The amendments took effect retroactively to January 1, 2004, the day the original Act came into force. The Act, as amended, provides that 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, i.e. once a demand for the performance is made. Thus, the Act, as amended, clarifies that the two-year limitation period for a demand obligation as evidenced by a promissory note payable on demand starts once a demand is made and dishonoured. However, the Act does not extend the same treatment to guarantees for underlying demand loans; a claim to recover on a guarantee must be commenced within two years of the date of discovery of the claim. As discussed below, the determination of the date upon which a claim is discovered in the context of a guarantee depends on whether the guarantee is considered “co-extensive” with the principal debt or independent of the principal debt.

The Common Law

It is a traditional common law principle in Ontario that if a guarantee is considered to be co-extensive with the principal debt, the limitation period for the guarantee starts to run when the limitation period for the principal debt starts. On

the other hand, if the guarantee is found to be independent of the principal debt, the limitation period for the guarantee depends on the terms of the guarantee and may start at a different time than the limitation period for the principal debt. Ontario case law, traditionally, has supported the proposition that, where the terms of a guarantee require that a demand be made upon the guarantor, liability does not arise until the demand is made and the limitation period starts to run upon the receipt of the demand, such that the limitation period on the guarantee runs independently of the limitation period for the principal debt.

However, recent case law in Ontario has resulted in some confusion regarding the application of the traditional legal principles relating to co-extensive and independent guarantees. In particular, in *Chorny*¹, the Ontario Superior Court (the “Court”) found that a demand made on a guarantee was unenforceable after the limitation period for the principal debt had expired. However, subsequent to *Chorny*, the Court clarified the law on the limitation period applicable to a demand guarantee in its October, 2008 decision in *Williamson*.²

2105673 Ontario Inc. v. Chorny

In *Chorny*, the plaintiff corporation initiated an action on three loans made in August, 2005 which came due one month later in September, 2005. The loans were evidenced by three term promissory notes and guaranteed by the defendant Chorny, pursuant to three guarantee agreements, which included a term requiring that the plaintiff corporation make a demand upon the guarantor prior to seeking to recover under the guarantee. (Interestingly, the terms of these guarantees were not discussed in *Chorny*, but were cited in *Williamson*). The plaintiff corporation commenced proceedings to enforce

¹ *2105673 Ontario Inc. v. Chorny* (2008), 90 O.R. (3d) 207 (S.C.J.) [*Chorny*].

² *The Bank of Nova Scotia v. Williamson*. Court file no.: 07-CV-335817PD1 (S.C.J.) [*Williamson*].

on the guarantees in December, 2007, after the limitation periods on the loans and notes had lapsed in September, 2007. However, at the time that the loans were made and at the time the plaintiff corporation commenced its action, the plaintiff corporation did not exist as a legal entity – it had been dissolved in February, 2004 by order of the Ministry of Consumer and Business Services and had not filed articles of revival until October, 2007.

The plaintiff corporation argued that the limitation period on the guarantees did not commence until a demand was made on the defendant Chorny in January, 2006 and, therefore, survived the expiry of the limitation period on the principal debts.

The Court found that the limitation periods started to run on the respective due dates of the loans, which came and went without payment by the principal debtors. Accordingly, in September, 2007, the limitation periods on the principal debts lapsed and they became unenforceable. Interestingly, applying the principle of co-extensiveness, the Court concluded that the limitation periods on the guarantees also lapsed when the limitation periods lapsed on the principal debts. The Court's finding that the guarantees were unenforceable upon the expiration of the limitation periods on the principal debts was a deviation from the traditional common law approach in Ontario.

The Bank of Nova Scotia v. Williamson

In *Williamson*, the Court reaffirmed the traditional common law approach in Ontario finding in favour of the plaintiff, the Bank of Nova Scotia (the "**Bank**"). The Bank advanced loans to Ancon Industries Inc. ("**Ancon**") beginning in 2001, which were guaranteed by the defendant, Anthony Williamson ("**Williamson**") in 2002. The guarantee contained a provision which stated that the guarantor's liability to make payment under the guarantee would arise immediately after demand for payment was made in writing. In October, 2004, Ancon defaulted on its loan obligations and the Bank made a demand for repayment on October 20, 2004. On the same day, the Bank also sent a letter to Williamson stating that if payment of the Bank's demand was not made as required, the Bank would take steps to recover payment from Williamson.

Ancon was subsequently deemed bankrupt in December, 2004. On June 12, 2007, the Bank sent Williamson a second letter demanding payment under the guarantee. When payment was not made, the Bank commenced an action against Williamson in July, 2007.

Williamson argued that the letter he received from the Bank on October 20, 2004 was a formal demand and that the limitation period ran from that date or, alternatively, from the time when the Bank knew that it would suffer a shortfall after the sale of Ancon's assets.

The Court found that the demand was made on June 12, 2007, noting that the Bank's second letter clearly made a formal demand while the first letter was a notice sent in the normal course of business, as a courtesy to Williamson. Accordingly, the Bank's action against Williamson was commenced well within the two-year limitation period under the Act.

The Court reaffirmed the traditional proposition that when a guarantee provides a demand as a condition precedent to the guarantor's obligations being triggered, a guarantor is not liable until a formal demand is actually made. The Court distinguished the decision in *Chorny* on its factual differences. In particular, the Court stated that the decision in *Chorny* turned on the fact that the limitation periods lapsed on the principal debts when the plaintiff corporation was dissolved. Since the principal debts became unenforceable, the Court in *Chorny* concluded that the guarantees were also unenforceable. In contrast, in *Williamson*, the Bank pursued its remedies against Ancon within the limitation period for the principal debt in the context of bankruptcy proceedings and, because there was a shortfall, the Court saw no unfairness in the Bank looking to Williamson to honour his guarantee.

Conclusion

In *Williamson*, the Court clarifies that the Act, as amended, has not affected well-settled common law principles regarding the obligations of a guarantor under, and a lender's ability to enforce, an independent guarantee. Unless it is otherwise stipulated in the guarantee agreement, there is no requirement that a demand be made upon the principal debtor and

the guarantor at the same time. As a result, in a guarantee agreement it is prudent from a lender's perspective to clearly provide a demand as a pre-condition to a guarantor's obligations being triggered, so that the limitation period does not commence until a formal demand is actually made by the lender.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

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