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## Bank cannot take advantage of mistake, court rules

Court clarifies doctrines of unilateral and mutual mistake

BY DONNA WILSON, ARTICLING STUDENT, AFFLECK GREENE MCMURTRY LLP

The Ontario Court of Appeal recently clarified the difference between mutual and unilateral contractual mistake in the case of *Royal Bank of Canada v. El-Bris Limited.*<sup>1</sup> Laskin J.A., writing for the court, explained that the four prerequisites set out by the Supreme Court of Canada in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club*<sup>2</sup> only apply to cases of unilateral, not mutual, contractual mistake.

The dispute arose between the Royal Bank of Canada ("RBC") and James Ellis, president and sole shareholder of El-Bris Limited, over a \$700,000 loan from the bank to Ellis. Ellis personally guaranteed the \$700,000 and also pledged a \$700,000 collateral mortgage to the bank on property that he owned. Ellis had been a customer of RBC for many years when this loan was executed in 1992.

By 2003 El-Bris had become insolvent and its borrowing from RBC had increased to approximately \$3.5 million. RBC asked Ellis to repay his loan under its security. Ellis paid \$700,000 and asked for a discharge of the collateral mortgage and a release of his guarantee. RBC discharged the collateral mortgage but refused to release Ellis from his guarantee.

RBC sued both Ellis and El-Bris when Ellis refused to pay the additional \$700,000. RBC argued that Ellis's obligations under the collateral mortgage and the guarantee were distinct. Ellis took the position that he gave the collateral mortgage as support for or security for his guarantee, and that they amounted to an obligation to pay \$700,000, not \$1,400,000 as RBC was insisting.

The trial judge granted judgement against the insolvent company El-Bris but dismissed the action

against Ellis. He found that the terms of the mortgage and guarantee create two distinct obligations by their wording. However, he found that based on the documentary and oral evidence of the parties there was a common intention that the collateral mortgage stand as security for Ellis's guarantee. Therefore Ellis's previous payment of \$700,000 extinguished his guarantee obligation to RBC.

On appeal, RBC argued that the trial judge failed in two respects. First, that an experienced businessman like Ellis should be held to the agreements that were clearly spelled out in the documents he signed. Second, that Ellis had failed to satisfy the four requirements for rectification from the Supreme Court of Canada in *Sylvan*. Laskin J.A. first dealt with the argument that Ellis failed to satisfy the four requirements of *Sylvan*. He used this opportunity to clarify the difference between unilateral mistake and mutual mistake.

In cases of mutual mistake, where neither party knew of the mistake, the court will rectify the contract not because it would amount to unfair dealing, but because it would be unfair for the court to enforce an agreement that neither party intended to consent to. In these cases, the party seeking rectification is merely required to demonstrate that the parties had a common intention to record their agreement in the manner alleged. Once this is shown, the court will rectify the contract so that it conforms with the agreement that the parties intended to make.

By contrast, in a case of unilateral mistake, where one party knew or ought to have known of the mistake in the written document, allowing that party to take advantage of that mistake would amount to

unfair dealing. Laskin J.A. explained that the four prerequisites required by *Sylvan* in a case of unilateral mistake are: (i) a previous oral agreement inconsistent with the written document; (ii) the other party knew or ought to have known of the mistake and permitting that party to take advantage of the mistake would amount to unfair dealing; (iii) the document can be precisely rewritten to express the parties' intention; and (iv) each of the first three prerequisites must be demonstrated by convincing proof.

Laskin J.A. wrote that this case was *not* a case of unilateral mistake. He wrote that the trial judge was reasonable to conclude that both parties intended to create only one \$700 000 obligation with the collateral mortgage and personal guarantee. Therefore the court was correct to rectify the contract to conform with the agreement that the parties had intended to make.

Turning to RBC's argument that Ellis is a sophisticated party who should be held to the contract as written, Laskin J.A. agreed that sophisticated parties cannot routinely look to rectification to correct mistakes in signed contracts. However, he found that allowing rectification in this case does not open the floodgates because this decision turns narrowly on its facts. On the other hand, disallowing rectification in this case would unjustly enrich the bank at Ellis's expense.



**For more information contact:**

Donna Wilson, Articling Student, Affleck Greene McMurtry LLP  
Tel: 416.883.0820  
Email: [dwilson@agmlawyers.com](mailto:dwilson@agmlawyers.com)

<sup>1</sup> 2008 ONCA 601, <http://www.canlii.org/en/on/onca/doc/2008/2008onca601/2008onca601.html>.

<sup>2</sup> *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, 2002 SCC 19, [2002] 1 S.C.R. 678, <http://scc.lexum.umontreal.ca/en/2002/2002scc19/2002scc19.html> [*Sylvan*].