

Independent Legal Advice: A Vaccination

Legal advice is like a vaccine. The administration of a small amount before you have a problem can prevent you from coming down with a lethal dose of it later on.

The Ontario Court of Appeal has recently released a decision which is helpful in clarifying the law relating to the requirement for independent legal advice to be provided to guarantors (and co-signors).

Many lenders were alarmed following the decision of an Ontario trial court judge in *MacKay v. Bank of Nova Scotia* in 1994. In that case, the court declared invalid a mortgage given by a fifty-seven year old mother to co-sign a loan to enable her adult daughter, who had a poor credit rating, to buy a trailer. The mother apparently understood the nature of the transaction, refused to obtain independent legal advice when urged to do so by the bank, and signed a waiver to that effect. However, the court noted that the transaction was clearly improvident for the mother, that her judgment was influenced by her love for her daughter, and that no one had cautioned her against proceeding with, or at least taking security on, the transaction. The court said that the bank was under a duty to insist on the mother obtaining independent legal advice, or refuse the loan. Having failed to do so, the bank could not enforce the mortgage, and, because the daughter was now bankrupt, had to write off the entire debt.

As a result of this case, some lenders feared (and many lawyers acting for co-signors or guarantors argued) that any co-signature or guarantee—particularly if given by a family member or friend of the principal debtor—without independent legal advice was unenforceable.

The law in this area was recently reviewed by the Ontario Court of Appeal in *Bank of Montreal v. Duguid*. In a 2/1 split decision, the majority held, in somewhat similar circumstances, that a co-signature given by a wife to secure her husband's business loan was enforceable, notwithstanding the absence of independent legal advice.

The court held that where:

1. there is a close relationship between the guarantor & the principal debtor (or the co-signatories);

2. the guarantor reposes trust and confidence in the principal debtor; and,
3. the transaction is disadvantageous to the guarantor;

a presumption of undue influence will arise. In the absence of evidence rebutting that presumption, the guarantee will not be enforced.

In *Duguid*, the court found that the bank was necessarily aware of the close relationship between the husband and the wife, and therefore had a duty (which it failed to perform) to assure itself that the wife's decision to co-sign was fully informed and voluntary. That duty could have been best discharged by advising the wife to obtain independent legal advice. The court also found that the transaction was disadvantageous to the wife, and carried with it risks of which the bank was aware, but did not caution the wife.

However, the co-signature was nevertheless held enforceable, as the wife did not prove that she generally reposed such trust and confidence in her husband as to give rise to a presumption of undue influence (i.e., a presumption that she would sign without making an informed and voluntary decision), nor that she had in fact been unduly influenced in this particular transaction.

Thus, in each case in which a lender seeks to enforce a guarantee or co-signature given, without independent legal advice, by an individual in a close relationship with the principal debtor, it will be necessary to investigate the circumstances of that relationship generally, and how it influenced the particular transaction in question, in order to determine the likelihood of enforceability.

The best advice remains to insist on independent legal advice in every such case. The same is true in any case where more than one party is to be liable on the debt, unless there can be no doubt that it is for the joint benefit of all co-signors (e.g., a mortgage to purchase a jointly-owned home).

No doubt the lending officer in *Duguid* concluded that it was good business not to burden his customers with the additional expense of legal advice, when it appeared to him (correctly, as the court confirmed) that they each understood exactly what they were doing.

In the end, nobody won: Mr. and Mrs. Duguid separated and he made an assignment in bankruptcy. Even though the bank was successful on the appeal, the court was critical of its conduct and denied it any compensation for the substantial costs of the appeal, and of the three-day trial that preceded it. Mrs. Duguid has appealed to the Supreme Court of Canada. Watch this space for further developments.

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