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Wife may be on hook for co-signing loan

Separate legal advice for couple and bank 'bullet-proofs' transaction

It happens all the time. The husband is having financial trouble and applies to his bank for a loan. The bank approves the loan but the man's wife must co-sign for the debt. Under some financial pressure from her husband, the wife signs the loan papers without being fully aware of what obligations they contain.

A variation of this scenario is when a couple's financial circumstances are healthy, but the husband wants to borrow money to expand his business or participate in some potentially lucrative investment. Again, the wife signs with blinders on as to the risks of the transaction.

Is the wife responsible when the husband defaults on the loan? If she signed a mortgage on the family home, can the lender toss her out of the house? Does it matter whether or not she got independent legal advice?

Two interesting Ontario court cases within the last year have canvassed these issues. Even though they reached opposite results, and despite the fact that one is headed to the Supreme Court of Canada shortly, together they provide an insight into the guidelines that apply when a wife wants out of a debt incurred for her husband's business.

The first case went to court over a loan made to Robert and Michael Gondosch, the owners of Stratford Toyota. Back in 1990, they approached the principals of two private companies, Gedja Holdings and Lotzmann Holdings, for additional funding for their business.

Gedja and Lotzmann had previously loaned money to the Gondosch brothers without security, but on this occasion they agreed to provide funding only if the brothers would provide mortgages on their own homes as security. They both agreed, even though it meant their wives would have to sign the mortgages.

Jasmina Belu, the lawyer who prepared the mortgages for the lenders Lotzmann and Gedja, had previously done legal work for the borrowers, the Gondosch brothers, in connection with the financing of Stratford Toyota. Since Lotzmann and Gedja were also shareholders in the car dealership, Belu realized there was a potential conflict of interest and recommended the borrowers obtain independent legal advice.

No such advice was obtained, either by the brothers or their wives. Each wife was told by her husband that if she failed to sign the mortgage he could lose the business and together they could lose their home. Each signed the mortgage at home without the presence or advice of a lawyer.

Eventually, the loans went into default. When the lenders Gedja and Lotzmann sought to realize against the houses, both wives claimed that the mortgages should be torn up because they had not received independent legal advice, and they had signed under "undue influence" by their husbands.

Justice Stephen Githero ruled that the mortgages were not enforceable against the wives. He reasoned, firstly, that the husbands had indeed exerted undue influence toward them in the signing of the mortgages. The lenders, he ruled, were stuck with the actions and knowledge of their own lawyer. She failed to insist on independent legal advice for the wives, did not explain the nature and terms of the mortgages to each wife in the absence of her husband, and took no steps to ensure that the wives signed the mortgages willingly and with sufficient knowledge of the risks. The mortgages were ruled invalid and the wives' transactions set aside.

In a similar case decided just four months before the Gedja and Gondosch decision, the Ontario Court of Appeal reached the opposite decision. Back in 1989, Mr. Duiguid (the court never reveals the first names of the parties) applied to the Bank of Montreal for an investment loan in a tax-driven condominium investment.

The bank agreed on condition that his wife, who was a real estate agent, also sign the promissory note. Contrary to its written policies, the bank did not suggest that Mrs. Duguid obtain independent legal or financial advice. Nor did the bank disclose that it had concerns about the financial viability of the condominium project where the money was to be invested.

Not only was the loan not repaid, but Mr. Duguid went bankrupt leaving his now-estranged wife holding the bag for repayment of \$87,000 U.S. The bank lost the case at trial for failing to disclose its concerns about the financing of the condominium, and for not following its own rules by insisting that the wife obtain independent legal advice.

On appeal, the bank fared much better. The Court of Appeal ruled that the bank was not prevented from recovery on the basis that it failed to follow its own internal procedures regarding independent legal advice. Nor was it under any obligation to disclose its views on the quality of the investment.

As well, said the Court of Appeal, this was not a case of presumed or actual undue influence. The wife was fairly sophisticated. The relationship between the husband and wife would not trigger a presumption of undue influence when the wife was asked to co-sign a promissory note. Unlike the Gondosch case, the evidence in the Duguid case showed there was no actual undue influence and the wife did not rely on the husband for financial advice.

The Court of Appeal admitted that the bank had a duty to inquire into the possibility of undue influence on the wife. It breached that duty by failing to advise the wife to seek independent legal advice. However, since there was no evidence presented of actual or presumed undue influence, the wife was allowed to avoid repayment of the debt. The transaction was not cancelled merely because of the bank's failure to take reasonable steps to ensure that the wife's consent was voluntary and informed.

That, however, is not the final word on the matter. In December, the Court of Appeal granted Mrs. Duguid permission to appeal to the Supreme Court of Canada.

In a typical situation where a husband wants to borrow money for business or investment purposes, there may be three different lawyers involved - one for the lender, one for the borrower husband, and one for the wife. For the protection of all parties, the courts have been insisting on separate legal representation.

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