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Love is blind - that's why there's legal advice

Parents who guarantee their child's mortgage need to take heed.

Nicole and Tom are a young couple in the process of buying their first home. Because they couldn't quite qualify for a mortgage based on their combined incomes, they needed a co-signer for the bank. Nicole's parents live in their own mortgage-free home.

Her father, Sam, has a substantial salaried income, and volunteered to co-sign the mortgage.

The couple was approved for their mortgage on condition that Sam guarantee repayment should his daughter and son-in-law ever default. Although the bank did not require that Sam be registered on title as a co-owner, it did insist that he receive independent legal advice.

When the three of them showed up in my office to sign the mortgage, Sam was extremely reluctant to take the mortgage papers to yet another lawyer. In his view, this was a make-work scheme by either the bank or the legal community designed to force him to pay extra legal fees unnecessarily.

When he asked me why it was necessary for him to receive legal advice from a lawyer who did not represent his daughter, I told him the story of Thelma MacKay and her run-in with the Bank of Nova Scotia.

MacKay was a 57-year-old separated mother of three with a monthly income of \$1,200.

Back in 1990, MacKay was asked by her eldest daughter Sheriann Luciano to help her get a bank loan.

Luciano and her common-law spouse Michael Mankiss had unsuccessfully tried to borrow money to buy a new mobile home, so they approached her mother to take out the loan herself.

The bank's loans officer told MacKay that the loan was \$45,000, and that it would be secured by a collateral mortgage on her condominium.

She was not told by the bank that, in addition to buying the trailer, the money would be used to retire her daughter's pre-existing \$20,000 loan with the bank and to pay off her \$10,000 credit card debt. Neither was MacKay told that her daughter and the common-law spouse had a bad credit rating.

When MacKay went to the bank to sign the mortgage on her condominium, the loans officer told her to obtain independent legal advice, but she refused to do so, saying it was too expensive and that she trusted her daughter.

She even signed a waiver saying she refused independent legal advice. She was never advised to take any security on the new trailer.

After two years of making payments on the \$45,000 loan, Sheriann and Michael filed for bankruptcy and their trustee sold the trailer. Since she was an unsecured creditor, MacKay got nothing.

MacKay hired lawyer J. Lester Davies to sue the Bank of Nova Scotia claiming the mortgage was invalid, and the bank sued her to enforce the mortgage.

"They say that love is blind," the court wrote in its decision. "The plaintiff, Thelma MacKay, found this out the hard way."

Fortunately for MacKay, however, the court ruled that the transaction was unconscionable and declared the mortgage invalid and of no effect at all.

The court said that parents are particularly susceptible to influence in their desire to help their children, and that they should be told the ramifications of the transaction by someone. Before proceeding with the loan a bank must insist that a borrower have the opportunity of being told in clear terms that the transaction is foolhardy.

In some situations, the court found, a lender must actually insist that the borrower obtain independent legal advice. Otherwise it must refuse the loan.

"When all is said and done," the judge said in the MacKay case, "there is the glaring omission in this case that no one ever said to the plaintiff (MacKay) in blunt terms that the transaction is entirely improvident and that she should not go ahead with it."

No longer can a bank escape its responsibility by merely recommending independent legal advice.

The court said it should have insisted on it or declined the loan.

Its failure to insist on the advice created a legal presumption of undue influence on MacKay.

When I told Nicole's father Sam the story of Thelma MacKay and her daughter's trailer, he said he now understood the reason for independent legal advice but, of course, it didn't apply to him because he trusted his daughter and it was too expensive (sound familiar?) and because he was a businessman who understood the ways of the world. Eventually, however, Sam obtained the advice and signed the mortgage.

Courts don't always distinguish between the sophisticated and the unsophisticated parent guaranteeing a child's mortgage, and when it was released in 1994, the MacKay case sent a chill throughout the legal and lending communities.

Now lenders routinely require independent legal advice in many parent-child loan guarantees.

So the next time a parent is asked to guarantee a child's mortgage, it may be worthwhile to remember Thelma MacKay and willingly accept the independent advice.

The extra cost of \$250 or so is cheap insurance that everybody is fully informed and advised when proceeding with the deal.