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The Guarantees Acknowledgement Act and Equity

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Cases Considered:
Bharwani v. Chengkalath, 2008 ABCA 148

Sometimes it becomes apparent when reading a decision that the court would have preferred to reach a different result. Usually this is because the law seems to compel the result the court reaches, but fairness demands another. The decisions of the Court of Queen's Bench and the Court of Appeal in *Bharwani v. Chengkalath* are examples of the constraints the law occasionally puts on a court's ability to do what seems right. The defendant in this case won, but it did not seem fair that she did.

The case involved the purchase of an accounting practice by Ram Chengkalath's professional corporation. The vendor agreed to finance a portion of the purchase price and Mr. Chengkalath agreed to provide security for the vendor take-back loan, including his personal guarantee and a collateral mortgage on his residence. However, his wife, the defendant Valsala Chengkalath, turned out to be the one who actually held title to their residence. The vendor's lawyer therefore demanded a Limited Personal Guarantee from her and a Collateral Mortgage on the residence.

Mrs. Chengkalath refused to sign the Limited Personal Guarantee and refused to execute the Collateral Mortgage sent to her by the vendor's lawyer. She did offer, however, to provide what she called an Acknowledgement of Indebtedness that she indicated would secure her equity in the residence and thus replace both the Limited Personal Guarantee and the Collateral Mortgage. She drafted this brief document which acknowledged the loan the vendors were making and then provided: "The undersigned grants to Esmail Bharwani, without any personal liability, as security for the repayment of the sum of $147,761.92, a charge on lands legally described as follows: [Legal Description]." This document was accepted by the vendor's lawyer in lieu of the Limited Personal Guarantee and Collateral Mortgage.

The purchase and sale of the accounting practice fell through. Mrs. Chengkalath was sued on her Acknowledgment of Indebtedness. She resisted that lawsuit on the basis that her Acknowledgement of Indebtedness was, in substance, a guarantee and therefore compliance with the *Guarantees Acknowledgement Act*, R.S.A. 2000, c. G-11 was required. Section 3 of the Act states that "(n)o guarantee has any effect unless the person entering into the obligation satisfies the requirements of the Act." Its requirements had not been satisfied in this case.

The *Guarantees Acknowledgment Act* is a piece of Depression-era legislation that is unique to Alberta. As the Court of Appeal noted (at para. 16, quoting the October 1970 Report #5 of the Alberta Institute of Law Research and Reform):

> . . . the *Guarantee Acknowledgment Act* is designed to protect the ordinary individual who, through lack of experience or understanding, might otherwise find himself subject to onerous liabilities at law, the nature and extent of which he did not properly appreciate when he entered into the undertaking in question. The statute seeks to provide this protection by requiring that the person giving the guarantee must appear before a notary public and that the latter must satisfy himself by examination that the guarantor is aware of the contents of the guarantee and understands it.

The statute is an early example of consumer protection legislation, requiring each individual guaranteeing the debt of another person to demonstrate their understanding of the substantive content of their guarantee before a person knowledgeable in the law. Mrs. Chengkalath, an Alberta lawyer, was therefore complaining that she had not demonstrated her understanding of a legal document which was her idea and which she had drafted.

Mrs. Chengkalath was successful in front of Master Laycock, who found the Acknowledgement of Indebtedness was indeed a guarantee that required compliance with the *Guarantees Acknowledgement Act*. The vendors appealed but in March of 2005 Mr. Justice Hawco found that the document's classification as a guarantee was not a triable issue.

Mr. Justice Hawco did however order a trial on the issue of whether or not the principles of estoppel applied to prevent Mrs. Chengkalath from raising the defence of non-compliance with the *Guarantees Acknowledgment Act*. This is the trial that was eventually heard by Madam Justice Romaine in the fall of 2006: *Bharwani v. Chengkalath*, 2006 ABQB 843. It is Madam Justice Romaine's decision as the trial judge that is the subject of this appeal just released by the Court of Appeal.

The trial judge had decided that Mrs. Chengkalath was not barred — estopped — from successfully raising the defence of non-compliance with the *Guarantees Acknowledgement Act*. She reached this decision even though she found (at para. 18) that Mrs. Chengkalath was not a credible witness. The trial judge noted that Mrs. Chengkalath had initially asserted at trial that she was not familiar with the *Guarantees Acknowledgement Act* even though she practiced law in Alberta. She had been forced to reverse her position on cross-examination, however, and conceded that she was aware of the legislation. The trial judge went further than merely finding Mrs. Chengkalath lacking in credibility as a witness. She found (at para. 19) that Mrs. Chengkalath had misled Master Laycock about her role in drafting the Acknowledgement of Indebtedness and had lied about her involvement as legal counsel.

Despite these adverse findings of fact, the trial judge nevertheless allowed Mrs. Chengkalath to rely on the lack of compliance with the *Guarantees Acknowledgement Act* for two different

reasons. The first reason was the vendors' failure to prove reliance to their detriment on the shared but mistaken assumption that Mrs. Chengkalath's Acknowledgment of Indebtedness did not need to comply with the *Guarantees Acknowledgment Act*. The trial judge held that the vendors' lawyer relied on that assumption, but the vendors relied on their lawyer, not the assumption. Her second reason was that the requirements of the *Guarantee Acknowledgment Act* could not be circumvented by the application of the equitable doctrine of estoppel. To allow it to do so would nullify a statutory requirement. Only this second reason was addressed by the Court of Appeal. They agreed with the trial judge that the *Guarantees Acknowledgment Act* must be interpreted to exclude the operation of estoppel.

The Court of Appeal, like the trial judge before them, relied upon the discussion by the Privy Council in *Maritime Electric Co. v. General Dairies Ltd.*, [1937] 1 D.L.R. 609 on the issue of whether estoppel can be allowed to defeat a statutory obligation. A court "should first of all determine the nature of the obligation imposed by the statute," stated Lord Maugham at 613, "and then consider whether the admission of an estoppel would nullify the statutory provision." Is there a clear and positive duty imposed by the statute which is incompatible with the operation of estoppel?

The Court of Appeal held that the *Guarantees Acknowledgement Act* imposes an unconditional and mandatory obligation upon a guarantor to appear before a notary public, acknowledge execution of the guarantee, and sign a prescribed form. As a result, the Court of Appeal found that "[i]t would infringe public policy to permit estoppel to defeat the need for compliance with the Act" (at para. 25). The Court of Appeal concluded by referring to the findings of fact made by the trial judge. They noted that the individual guarantor's actual knowledge of the obligations undertaken in the guarantee, or her status as a lawyer in this particular case, is not relevant.

The result of this decision is that Mrs. Chengkalath's Acknowledgment of Indebtedness was ineffective. Even though that document was her idea and its form the result of her legal drafting, she was able to rely on a statute intended to protect the ordinary individual who lacked the experience or understanding to appreciate the onerous legal liability a guarantee might entail. This result might seem unfair, but it is a typical result that follows from the application of a rule of general application applying to situations unforeseen by the legislature.

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