

on

## Insolvency Law

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The logo for Fraser Milner Casgrain LLP, consisting of the letters 'FMC' in white on a dark blue square background.

FRASER MILNER CASGRAIN LLP

### THE IMPORTANCE OF COMPLIANCE WITH THE GUARANTEES ACKNOWLEDGEMENT ACT (ALBERTA)

In *Bharwani v. Chengkalath* [2007] 2 W.W.R. 368, Justice Romaine of the Alberta Court of Queens Bench refused to allow the legal principle of estoppel to override the protection afforded to individuals when executing a guarantee.

In this case, Chengkalath entered into a purchase and sale agreement for the accounting practice of Bharwani (the "Plaintiff"). As part of the agreement, the Plaintiff carried a certain portion of the purchase price and in turn, the Plaintiff required security for such loan including a personal guarantee and a collateral mortgage on Chengkalath's residence.

During the period of due diligence, the Plaintiff's solicitor discovered that Chengkalath's wife (the "Defendant") had title to the residence. The Defendant, who is a barrister and solicitor, was acting as Chengkalath's counsel. Shortly after this discovery, the Plaintiff's solicitor requested the Defendant to provide a Limited Personal Guarantee and a Collateral Mortgage as security for the loan. In this regard, the Plaintiff's solicitor forwarded to the Defendant a draft Limited Personal Guarantee which included a Notarial Certificate in the form prescribed by the Guarantees Acknowledgment Act (Alberta), and a Collateral Mortgage, for her execution. The Defendant advised the Plaintiff's solicitor that, for personal reasons, she would not execute the draft Limited Personal Guarantee or the Collateral Mortgage. Instead, the Defendant produced a document she referred to as an Acknowledgement of Indebtedness. The Plaintiff's solicitor accepted the Acknowledgement of Indebtedness as a substitute for the Limited Personal Guarantee and Collateral Mortgage. The deal closed.

Over time, the deal soured and litigation was commenced by the Plaintiff. The Plaintiff claimed against the Defendant pursuant to the

Acknowledgment of Indebtedness. Initially, the Defendant sought and obtained summary judgment from a Master on the basis that the Acknowledgment of Indebtedness was a guarantee for which there has not been compliance with under the Guarantees Acknowledgment Act, in that there was no Notarial Certificate. On March 10, 2005, Justice Hawco ordered the following:

1. The plaintiff's appeal from the Order of Master Laycock dated February 7, 2005 is allowed to the extent that there is a triable issue with respect to the applicability of the principles of estoppel in contesting the defence of Ms. Chengkalath.
2. Subject to paragraph 1, the Acknowledgement of Indebtedness Agreement is a guarantee as defined under the Guarantees Acknowledgment Act and such classification is not a triable issue.

At trial, Justice Romaine reviewed the application of estoppel and the Guarantees Acknowledgment Act. Generally, estoppel means that a party is stopped or barred from using a particular defence or argument in court. In this case, the Plaintiff raised the argument that the Defendant, being a lawyer, was estopped from being able to use the defence that her Acknowledgement of Indebtedness failed to strictly comply with the technical requirements of the Guarantees Acknowledgment Act. The Act is unique in that it sets out a specific procedure which must be followed when having a personal guarantee executed in a financial transaction. The noteworthy section of the Act is as follows:

Requirements:

- (3) No guarantee has any effect unless the person entering into the obligation
  - (a) appears before a notary public,

- (b) acknowledges to the notary public that the person executed the guarantee, and
- (c) in the presence of the notary public signs a statement at the foot of the certificate of the notary public in the prescribed form.

Notwithstanding the requirements of section 3, the Plaintiff maintained that the Defendant was estopped from being able to use the Guarantees Acknowledgement Act as a defence. Justice Romaine did not agree with the Plaintiff. In writing her decision, Justice Romaine asserted that she was reluctant to allow an argument of estoppel to challenge the compliance of a law passed for the protection of the public. Justice Romaine wrote that the Guarantees Acknowledgement Act “imposes a positive obligation on persons entering into a guarantee transaction that is based on public policy” ... “I must therefore conclude that, even if the Plaintiff’s had been able to establish the requisite elements of estoppel, they could not rely on such estoppel to preclude the defendant from raising the defence of non-compliance with the Guarantees Acknowledgement Act”. The Plaintiff’s claim was dismissed.

The Court of Appeal has now been asked to override the protection Justice Romaine alludes to in her decision. More to follow on this public interest topic.

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