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OFFSHORE CASES
OCTOBER 2017

BERMUDA
SUPREME COURT

CLARIEN BANK -v- ELIZABETH RUTH KEMPE

[2017] SC (Bda) 79 Civ (3 October 2017)

GUARANTEE – WHETHER BANK OBLIGED TO ENSURE THAT GUARANTOR OBTAINED INDEPENDENT LEGAL ADVICE – WHETHER BANK LIABLE FOR FAILING TO COMPLY WITH ITS LEGAL OBLIGATIONS IN RELATION TO THE EXERCISE OF ITS FORECLOSURE RIGHTS UNDER A MORTGAGE

The Plaintiff ("the Bank"), brought proceedings against the Defendant, Elizabeth Ruth Kempe, to recover the unpaid portion of a mortgage debt that remained after the property was sold under the Bank's foreclosure rights. The Defendant was Guarantor for the mortgage.

The Defendant counterclaimed against the Bank for negligently:

1. selling at an undervalue based on a negligent valuation;
2. failing to ensure that she received independent legal advice in circumstances where she was to the Bank's knowledge under pressure from her divorce lawyers to enter into the Guarantee so as to settle with her ex-husband.

Background

As part of a divorce settlement, the Defendant became the protector of a trust on which the property was settled, and guaranteed the full mortgage debt of $1,199,700 under a credit facility letter in 2004. An additional $100,000 was added to the mortgage in 2008, which the Defendant's guarantee was extended to cover. The monies advanced were secured by Deeds of Further Charge over the property.

The trust defaulted on its mortgage payments in 2010 and in October 2012 the Bank obtained possession of the property. Having been valued at $1.45 million in late 2012, the property was sold in February 2014 for $1.2 million, leaving a deficit of $362,642 as of August 2014, with interest accruing at the rate of 6.5% per annum. The Bank brought proceedings against the Defendant in 2015 to recover this debt. The Defendant counterclaimed, as described above.

The Court noted that when the Defendant had assumed her obligations as guarantor of the mortgage in 2004, the property had been valued at some $2.4 million, twice the amount of the total mortgage debt. However, the global financial crisis resulted in a substantial decline in property values after 2008.

Governing legal principles

With regards to a mortgagee's (i.e. the Bank's) duties and liabilities, the judgment cited a number of cases including the following from *Edness -v- Bank of Bermuda Limited* [1998] Bda LR 51 Ground J, who took the law from the following formulation by Salmon LJ in *Cuckmere Brick Co. Ltd. & Anor. –v- Mutual Finance Ltd.* [1971] 2 All ER 633 at 646:
"*I accordingly conclude…that a mortgagee in exercising his power of sale does owe a duty to take reasonable precaution to obtain the true market value of the mortgaged property at the date on which he decides to sell it. No doubt in deciding whether he has fallen short of that duty, the facts must be looked at broadly and he will not be adjudged to be in default unless he is plainly on the wrong side of the line.*"

Kawaley, CJ said he had not identified any authorities which support the proposition that the Bank was legally obliged to ensure that the Defendant as a guarantor actually sought (or expressly waived the right to seek) independent legal advice before executing the Guarantee. He said such an obligation is only recognised in the context of transactions giving rise to a presumption of undue influence, and clear evidence of vulnerability and influence would be required to impeach the validity of a contract where no presumed undue influence arises.

Factual findings: was there a breach of duty by the Bank as mortgagee?

The Court found that the only inference to draw from all the evidence was that the Bank afforded the Trust every opportunity to effect a private sale before marketing the property itself after basic repairs. One offer of $1 million was received in May 2013 but the Bank negotiated and agreed a sale at $1.2 million. Meanwhile no other offers were received. Kawaley CJ said: "*This was compelling evidence that the [Bank] sold at the best possible market price in the circumstances, bearing mind that renting and hoping that property prices would rise was not a*

commercially viable option because renovations were required and the [Bank] had been 'holding fire' for several years."

The trustees own efforts at selling the property between 2010 and 2012 had yielded one offer of $1,375,000 which did not result in a sale. Kawaley CJ said: "*This was compelling evidence that closing a sale for $1.2 million was not 'plainly on the wrong side of the line'".* He accordingly found that the Defendant had failed to prove that the Bank failed to act reasonably in seeking to obtain the best possible market value in selling the property.

Factual findings: was the Guarantee tainted by undue influence because the Bank failed to ensure the Defendant obtained independent legal advice?

The Court found that the Defendant failed to present any credible evidence of undue influence, as in 2004 the Bank could have reasonably assumed she would have been advised on the Guarantee by her divorce lawyer and there was nothing unusual about the transaction to make the Bank suspect her of particular vulnerability. Furthermore, the credit letters in both 2005 and 2008 expressly provided that "*Mrs Kempe is advised to seek independent legal advice with regards to the Guarantee and the obligations thereunder."*

Kawaley, CJ concluded: "*Best banking practice would suggest that the Plaintiff ought to have not just advised the Defendant to secure independent legal advice, but also to have sought either confirmation that she had obtained such advice or a waiver as part of the standard contractual process: see e.g.* National Westminster Bank PLC -v- Lotay and Lotay *[2012] EWHC 1436 (QB). However, I am unable to find…that the Plaintiff's failure to do so invalidates the 2008 extension of the Guarantee. Such policies are best viewed as protective mechanisms adopted by banks to ward off undue influence claims, not steps the law positively requires to be taken.*"

The Court dismissed the Bank's counterclaim.

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.