In The Supreme Court of Bermuda

CIVIL JURISDICTION
2015: No. 109

B E T W E E N:

CLARIEN BANK

Plaintiff

-v-

ELIZABETH RUTH KEMPE

Defendant

JUDGMENT

(In Court)

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 the exercise of its foreclosure rights under a mortgage

Date of hearing: October 2, 2017

Mr Richard Horseman, Wakefield Quin Limited, for the Plaintiff
The Defendant appeared in person

Introductory

1. The present action was commenced by a Specially Endorsed Writ of Summons issued on the 13th March 2015. The Plaintiff's claim arose in the following way. In 1993, the Defendant's former husband settled 'The Quarries', 16 Pitts Bay Road, Pembroke ("the Property") on trust. As part of property adjustment arrangements made in divorce proceedings, the Property was transferred to new trustees subject to an existing mortgage of $303,038 and a further charge of $896,662. The Defendant became Protector of the Trust and the Defendant's ex-

husband was released from the Trust. Most significantly, for present purposes, the Defendant guaranteed the full mortgage debt under a Credit Facility Letter dated November 19, 2004. An additional $100,000 was added to the mortgage by a Credit facility letter dated September 3, 2008, which the Defendant's guarantee ("the Guarantee") was extended to cover. The monies advanced under each Credit Facility Letter were secured by Deeds of Further Charge over the Property.

2. The Trust defaulted in its mortgage payment obligations in or about 2010 and in October 2012 the Plaintiff obtained possession of the Property. The Property (having been valued at $1.45 million in late 2012) was sold on or about February 28, 2014 for $1.2 million leaving a deficit of $362,642.59 as at August 12, 2014 with interest accruing at the rate of 6.5% per annum. The Plaintiff brought the present proceedings to recover the unpaid portion of the mortgage debt after exhausting its foreclosure rights, under the Guarantee.

3. It is difficult to imagine a more unfortunate financial outcome for the Defendant. When she assumed her initial obligations under the Guarantee in March 2004, the Property had been valued (in what was undoubtedly a 'bull' real estate market) at some $2.4 million, twice the amount of the total mortgage debt. The September 3, 2008 further loan only raised the total indebtedness to $1.27 million, and there was probably no basis for perceiving at that point that the Property's value had done anything other than increased since 2004. Bernard Madoff was not arrested until on or about December 11, 2008, and this was one of the earliest emblematic events of the Global Financial Crisis, which had a delayed impact on Bermuda. Almost two years later the Property still received at least one valuation as high as $2.00 million.

4. Against this background, the Defendant counterclaimed against the Plaintiff (most significantly) 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 Plaintiff's knowledge under pressure from her divorce lawyers to enter into the Guarantee so as to settle with her ex-husband.

Governing legal principles

5. I have been assisted by counsel's reference to two authorities on a mortgagee's duties and liabilities. Firstly, in *Edness-v- The Bank of Bermuda Limited* [1998] Bda LR 51 , Ground J (as he then was) held (at pages 3- 5):

> "*I take 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, both on principle and authority, 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."*
>
> *That was subsequently approved and applied by the Privy Council in Tse Kwong Lam -v- Wong Chit Sen & Ors. [1983] 3 All ER 54 at 60F , and appears to have been followed in all subsequent cases.*
>
> *A more modern statement is to be found in the judgment of Sir Donald Nicholls V-C, in Palk -v- Mortgage Services Funding plc [1993] 2 All ER 481 at 486 :*
>
> > *'In the exercise of his rights over his security the mortgagee must act fairly towards the mortgagor. His interest in the property has priority over the interest of the mortgagor, and he is entitled to proceed on that footing. He can protect his own interest, but he is not entitled to conduct himself in a way which unfairly prejudices the mortgagor …. if he sells the property he cannot sell hastily at a knock-down price sufficient to pay off his debt. The mortgagor also has an interest in the property and is under a personal liability for the shortfall. The mortgagee must keep that in mind. He must exercise reasonable care to sell only at the proper market value.'*

The first part of that quotation was recently adopted by the Court of Appeal for Bermuda in Irving & Dorothy M. Lusher -v- Bruce Michael King *(civil appeal No. 14 of 1997) (20th November 1997)*[1] *...*

...the rule in such cases is that the mortgagee is liable for any negligence on the part of a valuer of real estate agent selected by him in connection with the sale. However, in approaching that question considerable allowance has to be given to the wide scope for differences of opinion in such matters as valuation, and the possibility that competent valuers can come up with differing valuations without negligence or fault on their part. As Salmon LJ put it in Cuckmere Brick Co. Ltd. -v- Mutual Finance Ltd. (supra) at p. 638:

> *'The valuation of a plot of land depends on the knowledge, experience, expertise and ability of the valuer. Valuation is not an exact science. Equally careful and competent valuers may differ within fairly wide limits about the value of any piece of land. But there are limits.'"*

6. I also adopt the following guiding principles from Fisher and Lightwood's '*Law of Mortgage*', upon which Mr Horseman also relied:

    - a mortgagee is under no duty to let a property if this will impede its sale (paragraph 29.57);

    - it would be irresponsible for a mortgagee to carry out repairs where the costs of doing so would be greater than the increase in the property's value and he is under no duty to carry out such repair's at his own expense (paragraph 29.64);

    - the party seeking to impugn the exercise of the power of sale bears the burden of proving a breach of the duty to take reasonable care to obtain the best price possible and a mortgagee will only be liable if he is "*plainly on the wrong side of the line*" (paragraph 30.24).

7. My own researches have not identified any authorities which support the proposition that the Plaintiff 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. Such an obligation is only well recognised in the

[1] [1994] Bda LR 14.

context of transactions giving rise to a presumption of undue influence e.g. a wife encumbering property she solely or jointly owns to secure the debts of her husband: *Barclays Bank PLC-v-Coleman and another* [1999] EWCA Civ J1221-74. In my judgment no such presumption arises in the context of a transaction entered into in the context of adversarial divorce proceedings between a husband and wife in which the wife is separately legally represented (the position here). However, even where no such presumption arises, the doctrine can be extended as well to other familial relationships and circumstances as well. In *Young-v-Young* [2013] Bda LR 9, I adopted, *inter alia*, the following principles articulated by Lord Nicholls in *Royal Bank of Scotland plc v Etridge* [2002] 2 AC 773 (HL) as reflecting the state of Bermudian law on the subject of undue influence in the contractual context:

> *'11. Even this test is not comprehensive. The principle is not confined to cases of abuse of trust and confidence. It also includes, for instance, cases where a vulnerable person has been exploited. Indeed, there is no single touchstone for determining whether the principle is applicable. Several expressions have been used in an endeavour to encapsulate the essence: trust and confidence, reliance, dependence or vulnerability on the one hand and ascendancy, domination or control on the other. None of these descriptions is perfect. None is all embracing. Each has its proper place.*
>
> *12. In CIBC Mortgages Plc v Pitt [1994] 1 AC 200 your Lordships' House decided that in cases of undue influence disadvantage is not a necessary ingredient of the cause of action. It is not essential that the transaction should be disadvantageous to the pressurised or influenced person, either in financial terms or in any other way. However, in the nature of things, questions of undue influence will not usually arise, and the exercise of undue influence is unlikely to occur, where the transaction is innocuous. The issue is likely to arise only when, in some respect, the transaction was disadvantageous either from the outset or as matters turned out….*
>
> *20. Proof that the complainant received advice from a third party before entering into the impugned transaction is one of the matters a court takes into account when weighing all the evidence. The weight, or importance, to be attached to such advice depends on all the circumstances. In the normal course, advice from a solicitor or other outside adviser can be expected to bring home to a complainant a proper understanding of what he or she is about to do. But a person may understand fully the implications of a proposed transaction, for instance, a substantial gift, and yet still be acting under the undue influence of another. Proof of outside advice does not, of itself, necessarily show that the subsequent completion of the transaction was free from the exercise of undue influence. Whether it will be proper to infer that outside advice had an emancipating effect, so that the*

transaction was not brought about by the exercise of undue influence, is a question of fact to be decided having regard to all the evidence in the case…"

8. In my judgment clear evidence of vulnerability and influence is required to impeach the validity of a contract where no presumed undue influence arises and there is nothing inherently unusual about the impugned transaction which on its face excites suspicion.

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

9. The Plaintiff relied on two witnesses in addition to the documentary record. The fact witness was the straightforward and entirely credible Ms. Patrice James, who attached all the key documents to her Witness Statement and updated the Plaintiff's monetary claim. She was unshaken under cross-examination and very vigorously responded to cross-examination about the state of the Property when the Plaintiff took possession of it describing, *inter alia*:

    - her inability to enter the house because of overgrown bush and mosquito infestation; and

    - expending approximately $30,000 to carrying out basic landscaping and structural repairs to ensure the vacant premises did not further deteriorate.

10. The Defendant was forced to admit in her own cross-examination that she had last seen the Property in January 2011, and accordingly had no direct knowledge of its condition in October 2012 when the Plaintiff assumed possession of it. The Plaintiff's sweeping complaints about the poor condition of the Property being exaggerated was most vividly undermined by an email dated June 13, 2011 from the Defendant's sons (who were occupying the apartment attached to the main house) to the Plaintiff upon which Mr Horseman relied:

    "*…As we explained, the last 12 months have been highly stressful as we have been the sole source of financing for the Quarries…the house has been available for rent for 6 months and tenants have not been found willing to move into the house without some renovation (which we cannot afford). We have recently appointed new agents who have recommended selling and we are going to follow that route aggressively*…"

11. The only inference to draw from all the evidence was that the Plaintiff afforded the Trust every opportunity to effect a private sale. In fact the 2008 Credit Facility Letter reflected an express agreement that the Trust would place the Property on the market for sale within three months. The Trust only reported one purchase offer to the Plaintiff in July 2012, an offer which was never pursued. Ms James explained that the Property was marketed from April 2013 after basic repairs had been carried out pursuant to a valuation report. One offer of $1million was received in May, 2013. The

Plaintiff did not simply accept this offer but negotiated and agreed a sale at $1.2 million which was completed in March 2014 without incurring the usual 5% agent's fee. Meanwhile, no other offers were received in the interim although various real estate agents were aware the Property was for sale. This was compelling evidence that the Plaintiff sold at the best possible market price in the circumstances, bearing in mind that renting and hoping that property prices would rise was not a commercially viable option because renovations were required and the Plaintiff had already been 'holding fire' for several years.

12. Against this background, the complaint that the valuation relied upon was negligently prepared and relied upon was wholly lacking in real world solidity. The starting point for any credible case of negligent valuation is tangible support for the proposition that a higher price could have been obtained in the market. I accepted Ms Suzanne Stones as an expert, even though she prepared the crucial valuation report and lacked the degree of independence which the Court would normally expect in a case where there were competing experts. In this case there was no opposing expert, and I regarded her (and the Defendant cross-examined her) mainly as a witness of fact as to her own November 2012 valuation. However she expressed two opinions which I found persuasive:

    (1) property valuation is partially a science and partially an art; and

    (2) the most reliable indicator of market value is what a purchaser is actually willing to pay.

13. Ms Stones readily omitted that the check-box valuation report, designed to lower expense, omitted certain features of the Property (e.g. its driveway and well) but explained that these omissions were largely due to the cursory nature of her review of the Property which she was unable to conveniently access because of overgrowth around it. She testified that these omissions would have had no material adverse effect on the valuation. Ms Stones also readily admitted that the properties she used for comparative pricing purposes were mostly further away from Hamilton than the Property, but she explained that finding good comparators was an inherent difficulty in a place as small as Bermuda. She was a credible witness who did her best to assist the Court in an objective manner.

14. The Defendant could not dispute an important aspect of Ms James' evidence which was a complete common sense answer to all of the criticisms of the Plaintiff's handling of the foreclosure and sale process. The Trustee's efforts at selling the Property between in and about 2010 and October 2012 yielded one offer which did not result in a sale. The offer price? $1,375,000. This was compelling evidence that closing a sale for $1.2 million was not "*plainly on the wrong side of the line*".

15. I accordingly am bound to find that the Defendant has failed to prove that the Plaintiff 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 Plaintiff failed to ensure that the Defendant obtained independent legal advice?

16. The Defendant failed to adduce any credible evidence that the original Guarantee was tainted by undue influence because she did not obtain independent legal advice. The bare assertion in her Witness Statement that the Plaintiff was aware of the fact that she was under pressure in 2004 from her own divorce lawyer to settle with her ex-husband in the divorce proceedings was never put to Ms James nor substantiated in any way. From the Plaintiff's perspective, it was reasonable to assume that the Defendant would have been advised by her divorce lawyer about whether the divorce settlement, of which the Guarantee was an integral part, was in her best interests. The suggestion that she was pressured in a way which vitiated her free will by her own lawyer and that the Plaintiff was aware of this is in my judgment inherently improbable.

17. I fully accept that the Defendant was for a variety of reasons feeling stressed and pressured when the Guarantee was entered into in 2004. But so would most parties to divorce proceedings. I am bound to find that from the Plaintiff's perspective, there was nothing sufficiently unusual about the transaction to put the Plaintiff on enquiry as to peculiar vulnerabilities on the Defendant's part. Assessed by reference to market conditions at the time, only a clairvoyant would have discerned that the Defendant was assuming any significant personal risk by entering into the Guarantee.

18. That apart, the Plaintiff relied on the fact that in both 2004 and 2008, the Credit Letter's expressly provided that "*Mrs Kempe is advised to seek independent legal advice with regards to the Guarantee and the obligations thereunder.*" As regards 2004, Mr Horseman also relied heavily on the fact that the Defendant had access to legal advice from her divorce lawyer and that it was reasonable for the Plaintiff to assume that she would obtain such independent advice. That inference is far easier to draw in relation to the 2004 lending than it is in relation to the 2008 lending and the speculative suggestion that the Defendant had access to legal advice from the Trustee's attorneys. Another difference in 2008, when the Defendant was again advised to obtain independent legal advice, is that there is the strong suggestion that the Plaintiff was at this juncture aware of a risk of a mortgage default. Hence the "OTHER CONDITIONS" including:

> "*The property known as 'The Quarries' must be listed for sale within three months. The Borrower is to inform the Bank when the listing occurs.*"

19. It is for the Defendant to prove that the 2008 extension of her liabilities under the Guarantee reflects a transaction which is tainted by undue influence. She has failed to do so. Whatever pressures she may have been under in 2004, it is unclear what pressures the Plaintiff was or ought to have been aware she was under in 2008. She proffered no or no solid explanation as to why she could not at this stage have obtained appropriate independent advice. Moreover, the evidence strongly suggests that the Property's value at this juncture meant that the transaction would still

reasonably have been viewed as fairly low risk proposition from the Defendant's perspective. Best banking practice would suggest that the Plaintiff ought to have not just advised the Plaintiff 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 Lotal* [2012] EWHC 1436 (QB). However, I am unable to find (in relation to a point that was not fully pursued or argued) 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.

20. The Defendant has failed to establish that her obligations under the Guarantee are wholly or partially vitiated because she did not obtain independent legal advice.

Conclusion

21. The Plaintiff's Counterclaim is dismissed. The Plaintiff is entitled to enter judgment for the outstanding balance of the mortgage debt ($443,667.28 as at October 2, 2017). I will hear the parties as to costs if required.

22. The Defendant presented her case with a dignity, resoluteness and restraint. At the end of the day, she most distinctly advanced a Portia like plea for mercy, a plea to which the law, regretfully, does not permit this Court to respond.

Dated this 3rd day of October, 2017 _____
IAN RC KAWALEY CJ