Undue Influence: Clarification of the Requirements on Lenders

Authors: Michele Gavin-Rizzuto, Associate | Ben Adamson, Director

The recent decision of the Bermuda Court of Appeal in Keimon Lavan Lawrence v. HSBC Bank Bermuda Ltd [2020] CA (Bda) Civ 10, clarifies the steps required by lenders to protect themselves from a claim of undue influence in relation to loan transactions.

The appeal in this case followed the decision of the Supreme Court not to set aside two default judgments entered against Keimon Lawrence and his father, Keith James. The judgments held that Mr Lawrence and Mr James should pay HSBC Bank Bermuda Ltd $3,609,666 million, together with interest, charges and costs, under the terms of a guarantee given by both men for a loan made by the bank to The Fitz Group Ltd (the driving force behind which was Alexander “Jerry” Ming, a friend of Mr James). Mr Lawrence and Mr James had put up their jointly-owned property in Warwick as security for the loan, which subsequently fell into default. The Court also declined to grant the defendants an injunction restraining the Bank from selling the Warwick property.

The Court of Appeal found that HSBC Bank Bermuda had failed to take adequate steps to ensure that Keimon Lawrence was not acting under the undue influence of his father, Keith James, when he agreed to put up his half of the house as security for the loan. In his judgment, the President of the Court of Appeal, Sir Christopher Clarke, identified several requirements that a lender should meet in order to protect itself from any later claim of undue influence.

Background

In 2008, Mr Ming was attempting to secure over $3 million in financing for a business venture. He asked his friend Mr James, who owned a large property, to assist him by standing as guarantor. However, Mr James owned the property jointly with his son, Mr Lawrence; both would therefore need to stand as guarantors to allow the entirety of their property to be charged as security. Mr James was to be paid $50,000 per year by Mr Ming for his assistance, totalling around $400,000 over the term of the loan. Mr Lawrence was not to receive any payment from Mr Ming.

Mr Lawrence initially had concerns about the proposal, but following a meeting with Mr Ming he agreed to act as guarantor. Mr James and Mr Lawrence then met with the lender. They were advised to obtain independent legal advice before deciding whether to provide the guarantee. It was not suggested that they may wish to get separate advice. Mr James did not disclose his commercial interest in the transaction to the lender and said that he was standing as guarantor because he was close friends with Mr Ming. Crucially, insofar as the lender was concerned there was no commercial benefit to father or son.

It was a precondition of the loan facility that the lender must receive a letter from a reputable attorney confirming that the terms of the guarantee had been explained to Mr James and Mr Lawrence and that they understood the same. The lender also suggested to Mr James that he should obtain financial information in relation to the business from Mr Ming and review this with an accountant. Mr Lawrence did not raise any concerns about entering into the transaction in front of the lender.

Mr James and Mr Lawrence duly sought legal advice and the required letter was sent by their attorney to the lender to satisfy the condition precedent. It stated, essentially, that the guarantors had been advised of the relevant terms, they professed to understand them, and they accepted the opinion given to them.

Mr James and Mr Lawrence executed the facility letters as guarantors, the loan was advanced to the borrower and the property was charged. Unfortunately, within a few years the borrower defaulted on the loan and the bank sought to enforce the guarantee and charge over their property. Mr James and Mr Lawrence applied to set aside the default judgment that was entered against them. This application was refused and Mr Lawrence brought an appeal against that decision.
Legal framework

In his appeal, the defence advanced by Mr Lawrence was that his father, Mr James, unduly influenced him to enter into the guarantee. Undue influence in relation to loan transactions has been the source of much judicial consideration in the United Kingdom. The leading cases are *Barclays Bank Plc v. O’Brien* [1994] 1 AC 180 and *Royal Bank of Scotland Plc v. Etridge (No 2)* [2002] 2 AC 773.

In essence, they establish that a lender is put ‘on inquiry’ whenever a wife offers to stand as surety for her husband’s debts. In order to insulate themselves from any potential undue influence that the husband may have exerted over the wife, the lender must require the wife to seek independent legal advice and obtain written confirmation from the solicitor that such advice has been provided.

When the application was heard in the Supreme Court, the Chief Justice held that the undue influence alleged by Mr Lawrence was conceptually different from that in *O’Brien* and *Etridge*. In those cases, it was the disadvantageous nature of the transaction as between borrower and surety which put the lender on notice. In this case, there was no disadvantageous transaction between Mr Lawrence and Mr James because they were both on the same side of the transaction as joint sureties. In effect, the Chief Justice’s finding was that the lender had not been put on inquiry that Mr Lawrence may have been unduly influenced by his father.

Unfortunately, the Chief Justice did not have his attention drawn to the English Court of Appeal decision in *First National Bank Plc v. Achampong* [2003] EWCA Civ 487 where undue influence was found, at first instance, to have been exerted by one surety upon another. This was in circumstances where the two sureties were husband and wife. The English Court of Appeal built on the observations of Lord Nicholls in *Etridge* and explained that the lender is put on inquiry whenever the relationship between the surety and the debtor is non-commercial. Once the lender is on inquiry, the position is not altered by the fact that undue influence has come from a co-surety rather than the debtor.

In the present case, the Court of Appeal found that the lender had been put on inquiry as to whether there had been any undue influence because, as far as it was concerned, this was a non-commercial arrangement between the borrower and both sureties. The commercial nature of Mr James’s arrangement with Mr Ming prevented him from relying on the doctrine of undue influence. Mr Lawrence, however, was not receiving payment from Mr Ming and so he could potentially rely on the doctrine.

The Court of Appeal built upon the *Achampong* decision by finding that there is no reason why the principle should only apply where the co-sureties are spouses or partners. The potential for undue influence is widely recognised in the parent-child relationship. In delivering the judgment of the Court of Appeal, Clarke P said that: "the principle is of particular importance in a case in which a father is poised to agree to guarantee a very large sum in order to help his friend and where the co-guarantor is to be his son, in respect of whom it is not apparent why he should subscribe to the guarantee and a charge of property of which he is joint owner, save to oblige his father".

Implications for lenders

The Court of Appeal endorsed the guidance provided in *Etridge* by Lord Nicholls. In summary, in order to insulate itself from the effects of any undue influence, a lender must substantially comply with the following requirements:

1. The lender should communicate directly with each individual surety.
2. It should inform the surety that for their own protection they will require written confirmation from the surety’s attorney that the nature of the documents and their practical implications for the surety have been fully explained.
3. The surety should be told that the purpose of this requirement is to prevent the surety from being able to later dispute that he is legally bound by the documents he has signed.
4. The surety should be asked to nominate an attorney to advise him. He should be told that if he wishes, this can be same attorney that is representing any co-surety or borrower (unless the lender has some reason for suspecting undue influence by the co-surety or borrower.)
5. If an attorney is already acting for both sureties and/or the borrower, the surety should be asked whether he would prefer that a different attorney should act for him in providing the necessary advice and confirmation.
6. The lender should not proceed with the transaction until it has received an appropriate response directly from the surety. Namely, a response that indicates that the surety has understood what the lender is seeking and why it is seeking it.
7. The lender must send the attorney advising the surety the necessary financial information in relation to the transaction. The lender will be best placed to judge what the information the attorney will need to see. Ordinarily, this should include: information on the purpose for which the proposed new facility has been requested; a copy of any written application by the borrower for the new facility; the current amount of the borrower’s indebtedness and details of any relevant accounts; the
amount of the borrower’s overdraft facility; the amount / terms of the new facility; and cash flow projections for servicing the
debt. The lender will need to obtain the borrower’s consent before this information can be shared, but if consent is not
provided, the transaction cannot proceed.

8. If the lender suspects that there has been undue influence, it must inform the attorney advising the surety of the facts giving
rise to its suspicion.

9. The lender must obtain written confirmation from the surety’s attorney he has fully explained the nature of the documents and
the practical implications they will have for the surety.

In this case, the lender failed to communicate directly with Mr Lawrence in the terms required, it failed to raise the question of separate
representation as between Mr James and Mr Lawrence, and it failed to receive a response directly from Mr Lawrence. The lender also
failed to provide any financial information to the attorney.

As a result, the written confirmation provided by Mr Lawrence’s attorney was insufficient. The attorney has to do more than just
consider the terms and liabilities arising from them. The reason why the attorney is to be provided with the financial information is so
that he can give some advice as to the extent of the risks that the surety is taking if he enters into the guarantee.

Lenders will, of course, be rightly concerned about confidentiality when it comes to sharing the borrower’s financial information. The
Court of Appeal has, however, made it clear that the borrower must provide consent for this information to be shared with the surety’s
attorney, if the transaction is to be able to proceed.

In light of the lender’s failure to substantially comply with the requirements, the Court of Appeal found that the lender had not done
enough to insulate itself from any undue influence by Mr James on Mr Lawrence. The default judgment was therefore set aside and the
case remitted to the Supreme Court to determine whether there had in fact been any undue influence.

This case brings home the importance for local lenders of ensuring that they have in place robust procedures to follow this guidance in
every case. The guidance will serve to protect both lenders and sureties. Once followed, it will allow the lender to have confidence that
any guarantee provided can be enforced and it will also help reduce the number of cases in which individuals are unduly influenced into
standing as surety for loan transactions.

Wider environment for lenders and proposals for greater supervision of lending practices

These requirements must also be viewed in light of the changing landscape in relation to lending in Bermuda. The Minister for Home
Affairs recently announced plans to amend the Consumer Protection Act 1999 to allow regulations to be created concerning consumer
protection for mortgages and loans. The proposals also include: introducing a code of conduct for lenders; establishing a tribunal to
deal with complaints and disputes; imposing penalties for non-compliance with the regulations; and providing community education on
lending. We will have to wait and see what form any regulations or code of conduct eventually takes, but the suggestion is that
significant changes are on the way. For example, the plans will affect foreclosures, the sale of property and how any subsequent
shortfall is dealt with.

The impetus for bringing forward these proposals appears to have been the global pandemic caused by Covid-19. The financial fall-out
from this is likely to place many borrowers in difficulty when it comes to meeting their loan obligations. The Government is keen to
reassure residents that they will be provided with appropriate protection. The Court is also likely to have sympathy with the plight of
many borrowers. Lenders therefore need to be prepared for greater regulation and scrutiny when it comes to lending practices and the
enforcement of security.
Authors:
Michele Gavin-Rizzuto
Associate
michele.gavin-rizzuto@conyers.com
+1 441 299 4949

Ben Adamson
Director
ben.adamson@conyers.com
+1 441 298 7824

Other Contact:
Christian R. Luthi
Director
christian.luthi@conyers.com
+1 441 298 7814

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For further information please contact: media@conyers.com