

TERRITORY OF THE VIRGIN ISLANDS

IN THE COURT OF APPEAL

HCVAP 2010/016

BETWEEN:

[1] HILDA ELISABETH STOUTT
(By her Guardians and Next Friends
Peggy Stoutt-Harewood and Preston Stoutt)
[2] PEGGY STOUTT-HAREWOOD
[3] PRESTON STOUTT

Appellants

and

FIRSTBANK PUERTO RICO

Respondent

Before:

The Hon. Mde. Ola Mae Edwards	Justice of Appeal
The Hon. Mr. Davidson Kelvin Baptiste	Justice of Appeal
The Hon. Mr. Don Mitchell	Justice of Appeal [Ag.]

Appearances:

Ms. Tana'ania Small-Davis, Ms. Akilah Anderson with her, for the Appellants
Mrs. Dionne Boreland-Fearon, with Mrs. Kimberly Crabbe-Adams for
the Respondent

2011: September 29;
2012: February 13.

*Banker and customer – Registered land charges – Mother securing business loans of son
– Mother elderly, housewifely, and mentally challenged – Mother not obtaining any benefit
from loan to knowledge of bank– Duty of bank – Possibility of undue influence – No
independent legal advice*

An elderly and mentally challenged housewifely mother put up her only real estate, her home, to secure the business debts of a company owned by her two sons. The bank described the loan as a “residential loan” on its documentation. The bank would have been aware that the mother did not play any part in the business of the company; that she did not obtain any benefit from the loan; that as an elderly, housewifely mother she may

have been susceptible to undue pressure. The bank did not insist that she obtain independent legal advice prior to accepting her mortgage charge. The business loan went into default and the bank attempted to enforce its security over the mother's house by selling it. Two of her children, having been appointed her legal guardians, applied to the court to set aside their mother's securities. The trial judge found that the bank had no knowledge of their mother's mental disorder at the time she executed the charges and that the charges could not be set aside. The mother appealed the finding on undue influence.

Held: allowing the appeal to the extent of any additional indebtedness due from Renport or Palmer to the bank which the appellant purported to guarantee; upholding the judge's finding as to the bank's entitlement to so much of the charge as relates solely to the balance of Mrs. Stouff's original indebtedness prior to its having been bundled into her guarantee of Renport's borrowings, that:

1. While the bank may not have had actual notice of the exercise of undue influence, or even of the existence of a relationship of trust and confidence between Mrs. Stouff and her son Palmer, it did know for a fact (from its having over the years handled the banking transactions for her son's company, Renport) that Mrs. Stouff played no part in the business of Renport. The bank should have been alert to the possibility that she had no incentive to enter into a transaction to secure Renport's defaulting debts and that as an elderly housewife mother she may have been susceptible to undue pressure. The bank must have known that, if she had no such incentive, and if she appeared not to appreciate the significance of what she was doing, no competent solicitor could have advised her to enter into a guarantee in the terms she did. They were under a duty to insist that Mrs. Stouff obtain independent legal advice.

Barclays Bank plc v O'Brien [1993] 4 All E.R. 417 applied.

2. The solicitor would be bound to inquire, of the bank if necessary, of the reason why it required additional security. Having discovered that the company was not meeting its previous loan commitments; that the mother's security was intended to enable the company's loan limit and overdraft facility to be increased; that the mother had no financial interest in the company; that she was not benefitting in any way from the proposed loan (other than the bundling in of her existing unimpugned loan); and, if he carried out his duty to her properly, that she did not appear from her answers to his questions to understand, due to some mental issue, the nature of the transaction she was proposing to enter into, he would be bound to advise Mrs. Stouff that the proposed guarantee of the company's debt was inadvisable.

Barclays Bank plc v O'Brien [1993] 4 All E.R. 417 applied.

3. Even if Mrs. Stoutt appeared to the solicitor to understand the transaction, if she wished to facilitate Renport by guaranteeing the increased amount of the loan and overdraft, he would have advised her to limit her guarantee to that amount, and not to the full amount of the company's indebtedness. This was particularly so in view of the fact that Renport's indebtedness was increasing and the possibility of Renport's failure to meet the commitment.

Barclays Bank plc v O'Brien [1993] 4 All E.R. 417 applied.

4. Applying the principles of undue influence to the bank in this case, the bank was fixed with constructive knowledge of the existence of undue influence exercised over Mrs. Stoutt in her offering up her property as security for her sons' company's indebtedness to the bank.

Barclays Bank plc v O'Brien [1993] 4 All E.R. 417 applied.

JUDGMENT

- [1] MITCHELL, J.A. [AG.]: Hilda Stoutt is the widow of the late H.S. Lavity Stoutt, first Chief Minister of the Virgin Islands. Peggy Stoutt-Harewood and Preston Stoutt, the other two appellants, are her daughter and son respectively. Palmer Stoutt is another son and the Director of a company called Renport Limited, but neither he nor the company is a party in the case. They all banked with the respondent, Firstbank Puerto Rico.
- [2] Palmer and Preston caused Renport to be incorporated in the Territory on 10th May 2001. They were both shareholders and directors in Renport. At that time, another bank, which is not a party to these proceedings, the Development Bank, held a registered charge over their mother's home, Atlantic House, registered in the BVI Land Registry as Parcel 11 of Block 2134B, West End Registration Section. Mrs. Stoutt's deceased husband had originally put up this property as security for a loan made by the Development Bank to another company, Quantum Development Ltd, which does not feature again in the proceedings. This loan had subsequently gone into default, and the Development Bank had commenced proceedings to exercise its rights as chargee against Atlantic House.

- [3] In September 2002 Preston and his mother, Mrs. Stoutt, applied to Firstbank for a loan of \$125,000.00. The proceeds of the Firstbank loan were to be used to pay off the delinquent loan at the Development Bank. Preston was, as found by the learned trial judge, Mrs. Stoutt's main caretaker. Firstbank granted the loan, and it was secured by a first charge on Mrs. Stoutt's home, the Development Bank's charge having been discharged. This re-financing arrangement effectively brought to an end the proceedings by the Development Bank to enforce its charge on Mrs. Stoutt's home. This charge in favour of Firstbank is not impugned.
- [4] In November 2005, Palmer and Mrs. Stoutt applied to the bank for a "residential loan" of \$320,000.00. The proceeds of the loan were to be applied to paying off (1) Renport's overdraft facility in the sum of \$187,014.10; (2) Mrs. Stoutt's 2002 loan in the sum of \$122,281.06 which was to be bundled in; and (3) various usual expenses associated with the granting of the loan such as Mrs. Stoutt's house insurance, the house taxes, and appraisal fees. The learned trial judge concluded from these payments that Mrs. Stoutt had received a benefit from the loan proceeds.
- [5] Firstbank approved this new loan of \$320,000.00, and on 14 December 2005, Mrs. Stoutt executed a charge over Atlantic House in favour of Firstbank to secure the amount. The loan was to be repaid by monthly instalments of \$2,210.16 over 30 years at 7.375% interest. Mrs. Stoutt duly appeared before a Notary Public and acknowledged, according to the printed words on the Charge Form, both her voluntary execution and her understanding of the instrument of charge. This charge is dated 22nd December 2005. Mr. Melvin Stoutt, an officer of Firstbank, signed the charge form on behalf of the bank. Melvin Stoutt is the nephew of the late H. Lavity Stoutt, the deceased husband of Mrs. Stoutt, and therefore Mrs. Stoutt's nephew. Neither on this occasion, nor on any other of the later occasions when Mrs. Stoutt was offering the bank her home as security for her son's indebtedness, did the bank insist that Mrs. Stoutt obtain legal advice on the

meaning and possible consequences of the transaction that she was entering into. This was the first of the impugned charges.

- [6] It appears that Renport was not doing well in its business. It exceeded its overdraft facility, and Firstbank required additional security. Consequently, on 25th April 2006, Mrs. Stoutt executed two further charges over Atlantic House. Firstbank added the amount of \$320,000.00 to the amount outstanding on Renport's account. The total indebtedness was now \$470,000.00, being a loan of \$370,000.00 and an overdraft facility of \$100,000.00, each secured by a separate charge. The first charge for \$370,000.00 was said, on its face, to be security for a loan in that amount made by Firstbank to Renport with interest of 9.5% per annum for the first five years, and thereafter the interest rate was subject to change. This loan was to be repaid by Renport by 125 equal consecutive monthly instalments, and the instalments for the first five years were in the amount of \$4,787.71.00. The second charge signed by Mrs. Stoutt was to secure Renport's \$100,000.00 overdraft line of credit with interest expressed to be at 2.5% per annum plus JP Morgan Prime Rate. Mrs. Stoutt appeared before the Notary Public to acknowledge her proper execution of both charges. And again, Mr. Melvin Stoutt signed on behalf of Firstbank. These were the second and third of the impugned charges. Neither Renport nor Palmer put up any property as security for either the company's loan or overdraft.
- [7] On the same 25th April 2006, Peggy and Preston each executed charge forms in favour of Firstbank over their respective properties. These were further securities in respect to the loan and overdraft of Renport in the amount of \$470,000.00. The first was to secure the loan of \$370,000.00. It was on the same terms as contained in the third charge executed by Mrs. Stoutt to secure the loan facility to Renport. Peggy gave the bank a charge over her Parcel 18 of Block 2135B, West End Registration Section. Preston gave a charge over Parcel 37 of Block 2337B, West End Registration Section. On the same day, they each appeared before the Notary Public to acknowledge in the usual form of words not only their voluntary

execution but that they understood the nature of the instrument. These charge forms were also signed by Mr. Melvin Stoutt on behalf of Firstbank. On the same day, Peggy and Preston also executed charges against their properties to secure the overdraft of \$100,000.00. These were on the same terms as the fourth charge executed by Mrs. Stoutt.

- [8] While there was no evidence that Peggy received any direct benefit from the granting of these securities, Preston, by contrast, was a shareholder and director of record of Renport at the relevant times. These four charges were the last of the seven charges that became the subject matter of this suit.
- [9] It would appear that neither Palmer, Renport, nor the other family members who had offered security as described above, satisfactorily serviced the indebtedness. Firstbank sought to exercise its rights as chargee against all three (3) of the properties that had been put up to secure the debt. In January 2007, the bank served the Stoutts with the requisite statutory notices.
- [10] In March 2007, no doubt as a result of threats being made by the bank to enforce the securities, Preston submitted an application on his and his mother's behalf to the bank. He proposed to consolidate the debt and to refinance the existing facilities. These negotiations got nowhere. There is no suggestion that Mrs. Stoutt was aware of this proposal made on her behalf.
- [11] Peggy and Preston now appear to have taken legal advice. They applied for and obtained orders to become Receivers of their mother's affairs on the basis that she was mentally incapacitated under the Mental Health Ordinance.¹ On 27th June 2007, the Stoutts filed this claim on Mrs. Stoutt's and their own behalf for orders that the seven charges placed on all their properties were invalidly obtained and ought to be set aside. These charges are registered as Instruments Nos. 27 of

¹ Cap 191, Revised Laws of the Virgin Islands.

2006, 1384 of 2006, 1385 of 2006, 1389 of 2006, 1390 of 2006, 1397 of 2006, and 1653 of 2006.

- [12] The medical evidence was that Mrs. Stoutt had been treated by Dr. Leonard C. Vander Linde of Michigan in the USA from the year 1991 to 1999 for a Schizoaffective Disorder. In 1999, Dr. Vander Linde came to the Territory at her family's request because she was unable to travel. He found her at that time to be "clearly psychotic, paranoid, disorganised and hostile. She was unable to adequately care for herself and could only manage with the help of her family." In his opinion, from 1999 to 2005 she was "chronically psychotic and mentally ill and she was not competent to enter into any legal contract." From September 2005, Mrs. Stoutt was treated for her mental condition by Dr. June Samuel of the Community Mental Health Services in the Territory. At that time Mrs. Stoutt was admitted to a facility for mental treatment. Dr. Samuel recorded that Mrs. Stoutt had a long history of psychiatric illness and had become non-compliant. She explained Schizoaffective Disorder as being:

"a mental disorder characterised by symptoms including delusions, hallucinations, thought disturbances and inappropriate interactions. However, unlike schizophrenia, in Schizoaffective Disorder there is a significant mood component and affected individuals may become depressed or manic or agitated. This disorder is ongoing and permanent and is controlled by medication. It also affects various aspects of brain functioning so individuals may have ongoing difficulties with social functioning."

These two psychiatric reports were not disputed by the bank, and the judge had no difficulty in finding that Mrs. Stoutt was suffering from a mental disorder such that her capacity to contract was impaired when she executed all three of the charges.

- [13] The learned trial judge concluded from the evidence that all of Preston, Peggy and Palmer had known that Mrs. Stoutt had been under the care of a psychiatrist since the year 1991. Yet they had allowed her to charge her home to Firstbank in 2002. The judge concluded that they had treated their mother as if she had the mental capacity to contract, yet they sought equitable relief now when it suited them.

There was evidence from the bank's witnesses that Mrs. Stoutt struck them as lucid and intelligent. From this she concluded that Mrs. Stoutt at first sight appeared to be well able to conduct her own affairs and that there was nothing in her manner which could have told anyone that she was suffering from any mental illness.

[14] The learned trial judge made no finding as to whether Mrs. Stoutt was aware of the nature of the transactions she was entering into, or whether she had a legal capacity to enter into the transactions, though it is implicit in her findings that she accepted that Mrs. Stoutt suffered from legal incapacity. This is quite apart from her apparent acceptance of the evidence that Mrs. Stoutt appeared to other persons to be in control of her facilities. Given the state of her psychosis there was evidence from which the learned trial judge could have expressly found that Mrs. Stoutt was not capable of understanding what she was being required by her sons to do and that she acted entirely under their influence in executing the charge forms and in appearing before the Notary Public to certify exactly the opposite state of affairs. This would be relevant when we come to consider the responsibilities of the bank on the issue of undue influence.

[15] The learned trial judge considered that the crucial question was whether the bank knew that it had either actual or constructive notice of Mrs. Stoutt's mental disorder at the relevant times in 2005 and 2006 when she executed the impugned charges. To establish this assertion, the Stoutts relied on the fact that Mr. Melvin Stoutt, who had executed the loan documents in question, was related to Mrs. Stoutt, admitted visiting Mrs. Stoutt on occasion, and must have known of her mental disorder, which knowledge must be attributed to the bank as he was an officer of the bank. Melvin Stoutt denied that he had any knowledge of Mrs. Stoutt's mental ailment. In the event, the Stoutts were unable to show the trial judge any direct communication that they made to Melvin Stott as to their mother's mental condition. Nor could they point to any other circumstances in which it could be said that that knowledge had been specifically imparted to Melvin Stoutt so that he

could be said to have constructive notice of her condition. The learned trial judge found that the bank through Melvin Stoutt had no knowledge of Mrs. Stoutt's mental disorder at the time she executed the charges, and that the charges could not be set aside on the grounds of Mrs. Stoutt's mental incapacity. Nor could the charges given by Preston and Peggy be challenged.

[16] The principle ground of appeal was that the judge, having found as a fact that Mrs. Stoutt was suffering from a mental disorder and that her capacity to contract was impaired at the time she executed all three of the charges, fell into error in concluding that Mrs. Stoutt was nevertheless bound by the charges. Yet, that is the law. A person who is not mentally capable of entering into a legal contract will nevertheless be bound by its terms unless she can prove that at the time the contract was made the other party to the contract had either actual or constructive notice of her incapacity. The law has been so at least since the case of *The Loan Company Limited v Stone*.² The principle was there laid down that:

“A contract made by a person of unsound mind is not voidable at that person's option if the other party to the contract believed at the time he made the contract that the person with whom he was dealing was of sound mind. In order to avoid a fair contract on the ground of insanity, the mental incapacity of the one must be known to the other of the contracting parties. A defendant who seeks to avoid a contract on the ground of his insanity, must plead and prove, not merely his incapacity, but also the plaintiff's knowledge of that fact, and unless he proves these two things he cannot succeed.”

The learned trial judge had the benefit of seeing and hearing the witnesses and it is now difficult to fault her conclusion from the evidence before her that the bank had neither actual nor constructive knowledge through Mr. Melvin Stoutt of Mrs. Stoutt's mental disorder. I find no merit in this ground of appeal. Peggy and Preston also appealed the finding by the learned trial judge against their claim that their charges were obtained as a result of undue influence, but they did not seriously pursue their appeals.

² [1892] 1 QB 599 per Lord Esher, M.R.

[17] The second ground upon which the Stoutts challenged the bank's entitlement to enforce the charges given by Mrs. Stoutt was the bank's constructive knowledge of a fiduciary relationship between her and Palmer, and the bank's failure to take any step to ensure that when she executed the charges she was not acting under the influence of Palmer. The learned trial judge found as follows:

“[51] Having examined all the circumstances surrounding the impugned transactions, I find that the Stoutts have failed to establish that Mrs. Stoutt had any special relationship with Palmer such that undue influence could be presumed on his part. Accordingly, if there was no special relationship which could give rise to the presumption of undue influence, then the bank had no duty to take steps to ensure that Mrs. Stoutt entered into the transactions freely and with full understanding of their nature and effect, a duty which is normally met by a bank ensuring that the person has independent legal advice.”

[18] Such a finding as the above is an inference drawn from the facts, which this Court is as well placed to draw as the learned trial judge was. The relevant facts and circumstances were that, other than the original loan negotiated by Mrs. Stoutt's late husband, the purpose of which is unknown, the new loans and overdraft in question were principally business loans. They were loans being made to a company in which there was no suggestion that Mrs. Stoutt had any interest. The new charges that Mrs. Stoutt was giving were no more than the securing of an existing business indebtedness owed to the bank by a company owned by a child or children of an elderly lady, and of whom there was no evidence that she had any business perspicacity. Did these circumstances place any obligation on the bank to ensure that she was not the victim of undue influence? Did the fact that a part of the loan proceeds went to pay off Mrs. Stoutt's insurance policy and land taxes amount to the receipt by Mrs. Stoutt of such a benefit that she could not now urge undue influence? What is the effect, if any, of the fact that a small part of the total indebtedness was a pre-existing obligation of Mrs. Stoutt that was rolled up by the bank into the total debt owed by Renport? Were both Peggy Stoutt-Harewood and Preston Stoutt under the influence of the bank through Melvin

Stoutt so that the bank could be considered to have coerced them into signing the relevant documents?

- [19] The essence of undue influence is the unconscionable abuse of influence that one person has over another applied so as to preclude the exercise of free and deliberate judgment. It has a connotation of impropriety. In the eyes of the law, undue influence means that an otherwise unobjectionable influence has been misused. The principles governing the application of the remedy of undue influence can be said to have been established by Lindley LJ in the case of *Allcard v Skinner*.³ In that case, Miss Allcard, a wealthy young woman, had joined a convent. She had bound herself to observe the rules of the order, including poverty, which required the members to give up all their property; seclusion, which prevented members from seeking outside advice without permission; and obedience, which told members to regard the word of Mother Superior as the voice of God. Miss Allcard transferred large sums of money and stocks to the Mother Superior. She later left the order and sought to set the gifts aside. The court held that the presumption of undue influence arose, but because Miss Allcard had delayed too long after leaving the order (and thus having become free of the Mother Superior's influence) before seeking rescission, it was held to be barred on the basis both of delay and affirmation. In the course of his judgment, Lindley LJ stated the doctrine of undue influence thus:

“The principle must be examined. What then is the principle? Is it that it is right and expedient to save persons from the consequences of their own folly? Or is it that it is right and expedient to save them from being victimized by other people? In my opinion the doctrine of undue influence is founded upon the second of these two principles. Courts of equity have never set aside gifts on the ground of the folly, imprudence, or want of foresight on the part of donors. The courts have always repudiated any such jurisdiction. *Huguenin v Baseley*⁴ is itself a clear authority to this effect. It would obviously be to encourage folly, recklessness, extravagance and vice if persons could get back property which they foolishly made away with, whether by giving it to charitable institutions or

³ [1887] 36 Ch D 145.

⁴ [1807] 14 Ves Jun 273.

by bestowing it on less worthy objects. On the other hand, to protect people from being forced, tricked or misled in any way by others into parting with their property is one of the most legitimate objects of all laws; and the equitable doctrine of undue influence has grown out of and been developed by the necessity of grappling with insidious forms of spiritual tyranny and with the infinite varieties of fraud.”

[20] The House of Lords in *Barclays Bank plc v O'Brien*⁵ has approved the threefold classification of undue influence adopted by the Court of Appeal in *Bank of Credit and Commerce International SA v Aboody*.⁶ Class 1 is where the complainant proves affirmatively that she was induced to enter into the transaction by the exercise of undue influence upon her. Class 2a is where she need prove only the existence of a relationship between her and the wrongdoer of a kind which is sufficient in law to give rise to a rebuttable presumption that any transaction between them which is favourable to the wrongdoer has been obtained by the exercise of undue influence. Class 2b is where she must prove the existence in fact of a relationship between her and the wrongdoer which, although not of a kind which falls within class 2a, was one under which the complainant was accustomed to repose trust and confidence in the wrongdoer, in which case the same rebuttable presumption arises. Actual undue influence is an equitable wrong committed by the dominant party against the other which makes it unconscionable for the dominant party to enforce his legal rights against the other. It is typically some express conduct overbearing the other party's will.

[21] We see the modern application of the principle in the judgment of the English Court of Appeal in the case of *Royal Bank of Scotland plc v Etridge (No. 2)*.⁷ Here, a bank sought to enforce its security against a wife who claimed to have been induced by her husband's undue influence or misrepresentation to charge the matrimonial home by way of security. The Court laid down a number of

⁵ [1993] 4 All ER 417 at 423, [1994] 1 AC 180 at 189.

⁶ [1992] 4 All ER 955.

⁷ [1998] 4 All E.R. 705.

principles in cases where the wife is advised by a solicitor as to her rights. These principles (taken from the headnote) included:

(1) Where the wife deals with the bank through a solicitor, whether acting for her alone or for her husband, the bank is ordinarily not put on inquiry and is not required to take any steps at all. Instead, the bank is entitled to assume that the solicitor has considered whether there is sufficient conflict of interest to make it necessary for him to advise her to obtain independent legal advice and it is not necessary for the bank to ask the solicitor to carry out his professional obligation to give proper advice to the wife or to confirm that he has done so (applying *Bank of Baroda v Rayare*⁸).

(2) Where the wife does not approach the bank through a solicitor, it is normally sufficient if the bank has urged her to obtain independent legal advice before entering into the transaction, especially if the solicitor provides confirmation that he has explained the transaction to the wife and that she appeared to understand it (applying *Massey v Midland Bank plc*⁹ and *Bank of Baroda v Rayare*¹⁰). When giving advice to the wife the solicitor is acting exclusively as her solicitor, regardless of whether he is unconnected with the husband or the wife or acts as the husband's solicitor or has agreed to act in a ministerial capacity as the bank's agent at completion. The bank is entitled to expect the solicitor to regard himself as owing a duty to the wife alone when giving her advice regardless of who introduced the solicitor to the wife and asked him to advise her or who is responsible for his fees. If the solicitor accepts the bank's

⁸ [1995] 2 FLR 376.

⁹ [1995] 1 All E.R. 929.

¹⁰ (supra).

instructions to advise the wife, he still acts as her solicitor and not the bank's solicitor when he interviews her.¹¹

- [22] The above principles all apply to the case where the bank has before it a wife who has had the benefit of independent legal advice, which was not the circumstance in our case. After laying down a number of further principles of particular relevance to such a circumstance, Stuart-Smith LJ concluded with a test numbered (10) in the headnote,¹²

(10) Ultimately, the issue is whether at the time value is given and in the light of all the information in the bank's possession, including its knowledge of the state of the account, the relationship of the parties, and the availability of legal advice for the wife, there is still a risk that the wife has entered into the transaction as the result of her husband's misrepresentation or undue influence.

It seems to me that these principles, particularly the last, are of general application, and are not limited to the husband/wife relationship. They are equally applicable to the relationship of a son in business and his elderly housewife mother, where the bank must be put on notice from the circumstances that the parties are not of equal bargaining power.

- [23] The earlier English Court of Appeal case of *Credit Lyonnais Bank Nederland NV v Burch*¹³ is instructive. The case involved an 18-year-old secretary, Ms. Burch, who entered into a banking transaction without the benefit of independent legal advice. Ms. Burch worked for a company controlled by a Mr. Pelosi, an Italian businessman. He was ten years older than her and she trusted him. She knew him to be a successful businessman and she visited his substantial home in

¹¹ *Midland Bank plc v Serter* [1995] 1 FLR 367; *Banco Exterior Internacional SA v Mann* [1995] 1 All E.R. 939; *Massey v Midland Bank plc* (supra); *Halifax Mortgage Services Ltd (formerly BNP Mortgages Ltd) v Stepsky* [1996] 2 All E.R. 277 and *Barclays Bank plc v Thompson* [1997] 4 All E.R. 816 applied.

¹² At paragraph 50.

¹³ [1997] 1 All ER 144.

London and his large villa in Italy. In addition to working for him during the day, she did baby-sitting at his home in the evenings and visited the family on weekends and for holidays in Italy. Ms. Burch with the assistance of a Building Society acquired a lease for 125 years of a second floor one-bedroomed flat in London. Five years later, Mr. Pelosi's company being in financial difficulties he asked her to put up her property as collateral security for an overdraft with the plaintiff bank. She agreed to do so. Mr. Pelosi had given security for a facility in the amount of £250,000.00 and the company wanted to increase it to £270,000.00. At this stage Miss Burch's property was valued at £100,000.00 but was subject to a first mortgage of £30,000.00. The bank instructed solicitors to act for them and directed the solicitors to ensure that Ms. Burch be advised to take independent legal advice.

[24] The solicitor wrote Ms. Burch advising her to take separate legal advice and pointing out to her the significant potential risk she may face. The letter explained that the document she was being asked to sign was unlimited both in amount and in time, and asked her whether this was actually what she had agreed. Ms. Burch did not get independent legal advice but signed a letter addressed to the solicitor acting for the bank confirming that she was fully aware of the implication of her offering her property as collateral for the increased overdraft facility. She stated that she understood that the guarantee was unlimited both in time and amount and that she wished to offer her guarantee on this basis. The solicitor's fees were paid by Mr. Pelosi or his company.

[25] Mr. Pelosi's company's financial difficulties were not resolved and in due course it went into liquidation. Mr. Pelosi's house in England was sold and he departed for Italy leaving Ms. Burch to face the music. The balance of his company's indebtedness was £56,000.00.

[26] Eventually, the bank issued proceedings for possession and payment against Ms. Burch. Ms. Burch defended the proceedings on the ground that she had been

induced to enter into the legal charge as a result of the undue influence Mr. Pelosi had exerted over her, and further that the bank was on notice, actual or constructive, of the undue influence.

[27] The court found that there existed between Mr. Pelosi and Ms. Burch such a relationship of trust and confidence as to raise a presumption of undue influence. It found that the bank knew that she was only an employee and that the transaction was manifestly to her disadvantage. It held that there was notice of facts which put the bank on inquiry.

[28] Applying *Barclays Bank plc v O'Brien*,¹⁴ the court then considered whether the bank had taken reasonable steps to satisfy itself that Ms. Burch's agreement to stand surety had been properly obtained. It gave judgment for Ms. Burch and granted the bank leave to appeal to the Court of Appeal.

[29] In the Court of Appeal it was held that it was not enough for Miss Burch to be told repeatedly that the mortgage was unlimited in time and amount. She could not assess the significance of that without being told of the extent of the company's current borrowings and the current limit, of which there had been no evidence. She might have thought that the limit was only being extended from £10,000.00 to £30,000.00. Had she known that the company's failure could have exposed her on the figures then current to the loss of her home and a personal debt of £200,000.00 on top, her reaction would have been very different. It was not enough for Ms. Burch to have been advised to take independent legal advice. It was at the least necessary that she should receive such advice. That is because the first thing an independent solicitor would have done, on looking at the draft legal charge, was to inquire as to the extent of the company's current borrowings and the current limit, and, on receiving the answers, to advise Miss Burch that she should not on any account enter into a transaction in that form.

¹⁴ (supra).

[30] Millett L.J. agreed that the transaction could not possibly stand. No court of equity could allow such a transaction to stand. Every one of the relevant facts was known to the bank when it accepted the security. The bank must accordingly be taken to have had notice of Miss Burch's equity, and must submit to the transaction being set aside against it. The transaction was not merely to the manifest disadvantage of Ms. Burch; it was one which, in the traditional phrase, shocks the conscience of the court. Miss Burch had committed herself to a personal liability far beyond her slender means, risking the loss of her home and personal bankruptcy, and obtained nothing in return beyond a relatively small and possibly temporary increase in the overdraft facility available to her employer, a company in which she had no financial interest. The transaction gave rise to grave suspicion. It cried aloud for an explanation. The court had no hesitation in dismissing the bank's appeal.

[31] In the present case, the only relationship between Mrs. Stoutt on the one hand and Palmer and Preston Stoutt (and their company Renport) on the other hand which has been proved (and of which the bank had knowledge) was that of an elderly mother and her sons whose business was in financial difficulties. This is not a relationship within class 1. In my view it is one within either class 2a or class 2b, it does not matter which.

Conclusion

[32] A bank is not expected in every case of a borrowing businessman son and a guaranteeing, elderly, housewifely mother to be put on notice that there is or might be a relationship of a kind which is sufficient in law to give rise to a rebuttable presumption that any transaction between them which is favourable to the son has been obtained by undue influence. At the same time it is clearly one which is capable of developing into a relationship of trust and confidence with the attendant risk of abuse. This is particularly so in the case of a business structure in which the mother played no part and obtained no benefit. When the bank required

additional security for the loan and overdraft facility that it had extended to Palmer and his company Renport, it should have been put on notice when he produced his elderly mother who was proposing to put up her home, her only real property, as security for his business loan. This was particularly so as the bank was requiring Mrs. Stoutt to secure not merely the additional increase in the loan but, as in Ms. Burch's case, the company's entire loan and overdraft facility. Mrs. Stoutt obtained no benefit from this transaction besides the rolling up of her previous home loan. The payment of Mrs. Stoutt's land tax, insurance, and valuation fees on the granting of the loan was not a benefit to Mrs. Stoutt. There is nothing to suggest that Mrs. Stoutt required the land tax, insurance, and assessment to be paid otherwise than for the purposes of completing the security transaction that she was entering into for the benefit of her son. These are the standard costs associated with a bank loan.

[33] Additionally, Mrs. Stoutt has established through the medical witnesses called on her behalf that she had at least since the year 1991 been suffering from a Schizoaffective Disorder which on the evidence left her psychotic, paranoid, disorganised and hostile. She was at all relevant times unable to adequately care for herself and could only manage with the help of her family. From at least the year 1999 she was chronically psychotic and mentally ill and not competent to enter into any legal contract. To the extent that she was helped by her family to enter into these banking transactions which transactions were clearly not of any benefit to herself but of benefit only to the business interests of her children, she was clearly acting under their undue influence. Not that there is any finding that this situation was known to the bank.

[34] Adapting the words of Millett L.J., while it was for Mrs. Stoutt to prove that the relationship between her and Palmer and Renport (and to some extent Preston) had developed into a relationship of trust and confidence, she did not have to prove it by direct evidence or as a primary fact. Mrs. Stoutt's mental condition would not have permitted her to testify as to any part of the transaction, even

assuming that she understood what she had done. It was sufficient for her, or rather for Preston and Peggy to prove on her behalf, facts from which the existence of a relationship of trust and confidence could be inferred. In the present case, the excessively onerous nature of the transaction into which she was persuaded to enter, coupled with the fact that she did so at the request of either Palmer or Preston, is in my judgment quite enough to justify the inference that the relationship of son and mother had ripened into something more and that there had come into existence between them a relationship of trust and confidence which Palmer apparently improperly exploited for his own benefit.

[35] The mere fact that a transaction is improvident or manifestly disadvantageous to one party is not sufficient by itself to give rise to a presumption that it has been obtained by the exercise of undue influence. But, where it is obtained by a party between whom and the complainant there is a relationship like that of mother and son which is easily capable of developing into a relationship of trust and confidence, the nature of the transaction may be sufficient to justify the inference that such a development has taken place. It becomes unavoidable when the mother in question is proven to be elderly and suffering from a psychotic condition that leaves her mentally incompetent. Where the transaction is so extravagantly improvident that it is virtually inexplicable on any other basis, the inference will be readily drawn. Mrs. Stoutt had no incentive to induce her to enter into the transaction. No competent solicitor could possibly have advised her to enter into it. He would be bound to warn her against it in the strongest possible terms, and to have refrained from acting for her further if she had persisted in it against his advice. The bank should have appreciated that the possibility of influence existed. It was sufficient to have put the bank on inquiry. For its own protection, it should have insisted that Mrs. Stoutt take legal advice. It did not do so.

[36] While on the subject of the taking of legal advice by this elderly mother seeking to guarantee or otherwise secure her son's business borrowing, it is important to

bear in mind the warning given by Millett L.J.¹⁵ in *Ms. Burch's* case. Even if the bank had insisted that the loan and overdraft facility would not be granted unless Mrs. Stoutt had taken independent legal advice that would not necessarily have made any difference. Such advice is neither always necessary nor always sufficient. The result does not depend mechanically on the presence or absence of legal advice. As between the wrongdoer and the complainant, the existence of independent legal advice may go some way to rebut a presumption of undue influence. The presumption is not rebutted by showing that the complainant understood what she was doing and intended to do it. The wrongdoer can rebut the presumption only by showing that the complainant was either free from any undue influence on his part or had been placed, by the receipt of independent advice, in an equivalent position. This involves showing that she was advised as to the propriety of the transaction by an adviser fully informed of all the material facts. As regards the bank which has been put on enquiry of the possible existence of some impropriety by the circumstances described above and known to the bank, and which bank wishes to avoid being fixed with constructive notice, one means of doing so is to ensure that the complainant obtains competent and independent legal advice before entering into the transaction.

- [37] In the present case, while the bank may not have had actual notice of the exercise of undue influence, or even of the existence of a relationship of trust and confidence between Mrs. Stoutt and Palmer, it did know for a fact (from its having over the years handled the banking transactions for Renport) that Mrs. Stoutt played no part in the business of Renport. The bank should have been alert to the possibility that she had no incentive to enter into a transaction to secure Renport's defaulting debts and that as an elderly housewife mother she may have been susceptible to undue pressure. The bank must have known that, if she had no such incentive, and if she appeared not to appreciate the significance of what she was doing, no competent solicitor could have advised her to enter into a guarantee

¹⁵ At p.156 of his judgment in *Credit Lyonnais v Burch* (supra).

in the terms she did. They were under a duty to insist that Mrs. Stoutt obtain independent legal advice.

[38] The solicitor would be bound to inquire, of the bank if necessary, of the reason why it required additional security. Having discovered that Palmer's company, Renport, was not meeting its previous loan commitments; that the mother's security was intended to enable the company's loan limit and overdraft facility to be increased; that the mother had no financial interest in the company; that she was not benefitting in any way from the proposed loan (other than the bundling in of her existing unimpugned loan); and, if he carried out his duty to her properly, that she did not appear from her answers to his questions to understand, due to some mental issue, the nature of the transaction she was proposing to enter into, he would be bound to advise Mrs. Stoutt that the proposed guarantee of the company's debt was inadvisable.

[39] Even if Mrs. Stoutt appeared to the solicitor to understand the transaction, if she wished to facilitate Palmer by guaranteeing the increased amount of Renport's loan and overdraft, he would have advised her to limit her guarantee to that amount, and not to the full amount of the company's indebtedness. This was particularly so in view of the fact that Renport's indebtedness was increasing and the possibility of Renport's failure to meet the commitment.

[40] Applying the principles of undue influence to the bank in this case, the bank is fixed with constructive knowledge of the existence of undue influence exercised over Mrs. Stoutt in her offering up her property as security for her son's company's indebtedness to the bank.

[41] I would therefore allow Mrs. Stoutt's appeal in part. I would allow it to the extent of any additional indebtedness due from Renport or Palmer to Firstbank which Mrs. Stoutt purported to guarantee. I would uphold the judge's finding as to the bank's entitlement to so much of the charge as relates solely to the balance of her original

indebtedness prior to its having been bundled into her guarantee of Renport's borrowings. I would dismiss the appeals of Peggy and Preston. They were adult business persons fully aware of the risk they were taking in entering into this agreement to secure Renport's business debts. I would order that in relation to Mrs. Stoutt both she and the bank should bear their own costs in this Court and in the court below, she having only partially succeeded on her appeal. The bank is entitled to one half of its prescribed costs in this Court and in the court below as against Peggy and Preston.

Don Mitchell
Justice of Appeal [Ag.]

Ola Mae Edwards
Justice of Appeal

Davidson Kelvin Baptiste
Justice of Appeal