

Circular S/02/237

12 October 2002

All Member Banks  
The Hong Kong Association of Banks

*Total no. of pages: 4  
(If all pages are not received clearly,  
please telephone 2521 1169)*

Dear Sirs

**Legal Representation in Transactions Involving  
Guarantees or Security Provided by Third Parties**

Members will no doubt be aware of the UK House of Lords decision in Royal Bank of Scotland & Etridge (No.2) and other appeals [2001] 4 All ER 499. This case has now been followed in a number of Hong Kong cases.

These cases involve the situation where a person providing a guarantee or security for the borrowing of another party is under undue influence from the borrower.

The cases deal with the situation where a person providing a guarantee or security for the borrowing of another party (the "borrower") is able to show that he or she was unduly influenced by the borrower at the time of the execution of the guarantee or security. In cases where undue influence is established the Courts have set aside the guarantee or security. The most common case of undue influence is where the party providing the guarantee or security is the wife of the borrower although undue influence can also arise in other circumstances. The other cases are cases where the relationship between the party providing the guarantee or security and the borrower is non-commercial, for example, the relationship between parents and children or grandchildren, client and solicitor, doctor and patient, trustee and beneficiary.

The significance of the Etridge case is that it lays down the principles to be applied in relation to:

- (a) Whether the transaction was affected by undue influence;

- (b) If so, whether the bank was put on enquiry; and
- (c) If so, did the bank take reasonable steps to ensure that there was no undue influence.

In cases where the transaction is potentially affected by undue influence the Etridge case sets out the steps to be taken to ensure that there was no undue influence. Basically these steps require the provision of information and advice to the potentially undue influenced party prior to the execution of the guarantee and security and a recommendation for that party to obtain independent legal advice.

This information, advice and recommendation can be given by the bank or the bank's solicitor and in providing the information, advice and recommendation, the bank or the bank's solicitor should be careful to follow the guidelines set out in the Etridge case.

If members are not already aware of the Etridge case or its implication, they should consult their legal advisers as the purpose of this circular is not to advise members of the detailed requirements of the case.

Rather the purpose of this circular is to deal with a problem raised by The Law Society of Hong Kong in relation to the giving by banks of instructions to solicitors for the handling of transactions where the possibility of undue influence arises.

The difficulty is that in giving instructions to solicitors to handle transactions, where the possibility of undue influence arises, the instructions to the solicitor do not clearly state whether or not there is a party who may be the subject of undue influence and if there is, whether it is the responsibility of the solicitor or the bank to handle the procedures recommended in the Etridge case to ensure that there is no undue influence.

The difficulty which potentially arises in these cases is that the solicitor may think that the bank is taking the necessary steps and the bank may think that the solicitor is dealing with this, with the result that neither the solicitor nor the bank takes the necessary steps and ultimately the guarantee or security is at risk of being set aside.

To avoid this situation arising, we would recommend that standard letters of instruction to solicitors in cases where a third party is providing a guarantee or security should contain a paragraph along the lines of the following:

Case 1

[Where the bank believes that there is no potentially undue influenced party.]

“There is no potentially undue influenced party in relation to this matter and accordingly, there is no need to provide information and advice to any other party”.

OR

Case 2

[Where the solicitor will give information and advice to the potentially undue influenced party.]

“We would request that you provide the necessary information and advice to [potentially undue influenced party] and follow the relevant procedures to ensure that the [guarantee/security] provided by [potentially undue influenced party] is not liable to be set aside on grounds of undue influence”.

OR

Case 3

[Where the bank will give information and advice to the potentially undue influenced party.]

“Please note that we will be responsible for providing the necessary information and advice to [potentially undue influenced party] and follow the relevant procedures to ensure that the [guarantee/security] provided by [potentially under influenced party] is not liable to be set aside on grounds of undue influence.”

If none of these statements are included in a letter of instruction in a case where a guarantee or security is provided by a third party, the solicitor will revert to the bank to obtain specific instructions on the matter with a view to clarifying how he should proceed.

In the event of Case 1, the solicitor may revert to the bank if he considers that there is a potentially undue influenced party, in which case it will be necessary for the bank to give instructions either in the form of Case 2 or Case 3.

In the event of Case 2, the bank will need to supply the solicitor with information regarding the borrower's accounts to enable the solicitor to pass the necessary information on to the potentially undue influenced party.

Also in the event of Case 2, instruction letters to solicitors should avoid using wording to the effect that the solicitor is to act exclusively for the bank because in giving information and advice to the undue influenced party, the solicitor will need to act for that party and so it will not be possible for the solicitor to act exclusively for the bank.

If these procedures are followed, we believe that there will be no misunderstanding regarding the proper allocation of responsibility between the solicitor and the bank as to providing the necessary information or advice to the potentially unduly influenced party, with the result that the incidence of security being set aside by reason of undue influence will be kept to a minimum.

Yours faithfully

Eva Wong  
Secretary