

**LEGALUPDATE**

A DREW &amp; NAPIER PUBLICATION

**CASE UPDATE****Singapore High Court Affirms Principles Relating To Mortgagee's Duty of Care In Exercising Power Of Sale****Beckett Pte Ltd v Deutsche Bank AG and Another [2007] SGHC 153****Executive Summary**

In the recent widely anticipated decision of *Beckett Pte Ltd v Deutsche Bank AG and Another* [2007] SGHC 153, the Singapore High Court affirmed that a mortgagee exercising its power of sale over a security is under a duty to act in good faith and to take reasonable care to obtain the true market value or the proper price of the mortgaged property at the date on which it decides to sell it.

**Background Facts**

The plaintiff, Beckett Pte Ltd ("**Beckett**"), is a Singapore investment-holding company. In 1997, its Indonesian subsidiary, PT Asminco Bara Utama ("**Asminco**"), obtained a bridging loan of US\$100 million (the "**Loan**") from Deutsche Bank AG (the "**Bank**") for the purpose of financing its acquisition of an increased stake in two Indonesian companies engaged in the mining and transport of coal in Kalimantan, namely, PT Adaro Indonesia ("**Adaro**") and PT Indonesia Bulk Terminal ("**IBT**").

Beckett guaranteed the repayment of the Loan. The Bank also obtained a pledge of the following shares as security for the repayment of the Loan:

- (a) Beckett's shares (the "**SME Shares**") in Asminco's direct holding company, PT Swabara Mining and Energy ("**SME**");
- (b) SME's shares in Asminco (the "**Asminco Shares**"); and
- (c) Asminco's shares in Adaro and IBT (the "**Adaro and IBT Shares**"),

(the SME Shares, the Asminco Shares and the Adaro and IBT Shares being collectively referred to as the "**Pledged Shares**").

Asminco defaulted on the repayment of the Loan. In November 2001, the Bank sold, by way of private sale, the Pledged Shares together with an assignment of all the Bank's rights under Beckett's guarantee and the Loan to PT Dianlia Setyamukti for US\$46 million. The Bank did not undertake an independent valuation of the Pledged Shares in contemplation of the sale.

In February 2002, Beckett was informed that the Bank had sold the SME Shares for US\$800,000 and in March 2002, the Bank demanded payment under the guarantee of the outstanding Loan said to be owing by Asminco to it.

Beckett commenced an action against the Bank, claiming that the Bank had breached duties owed to it as pledgee/mortgagee of the SME Shares. It also claimed that the Bank had breached its duty owed to Beckett (as guarantor of

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Asminco's debt) to take reasonable care to obtain a true value for the Pledged Shares or to obtain the best possible price for them. In Beckett's view, the Pledged Shares had been sold at a gross undervalue; if the Bank had taken reasonable care in selling the Pledged Shares, the proceeds from the sale would have exceeded the amount outstanding under the Loan.

The Bank counterclaimed against Beckett (as guarantor of the Loan) for a sum in excess of US\$98 million, being the amount due and owing under the Loan as at 28 May 2004.

### Decision of the High Court

#### *Whether the Bank had properly exercised its power of sale in respect of the shares*

The court noted that the legal position as regards a mortgagee's duties in the sale of a security was settled in Singapore. The mortgagee has two duties: the duty to act in good faith and the duty to take reasonable care to obtain the true market value or the proper price of the mortgaged property at the date on which it decides to sell it. In this connection, Kan Ting Chiu J, who delivered the judgment of the court, also provided the following guidance:

- Before exercising its power of sale, the mortgagee must inform itself of the value and the price obtainable for the property before agreeing to sell it.
- When that is established, the mortgagee must next determine whether the price actually obtainable is a reasonable price in the circumstances.
- The onus is on the mortgagee as the pledgee/vendor of the property to show that the security was properly sold.

In this case, the Bank was found to have failed to discharge its duties as pledgee when it sold the SME Shares. Adopting the reasoning and guidance proffered in English case law, the court observed that the Bank ought to have taken particular care to obtain valuations from experts in the coal mining and transportation industries as well as to make the availability of the Pledged Shares known in the relevant marketplace. On the contrary, the Bank failed to secure any form of valuation for the shares. Instead of selling the shares on the open market, the Bank applied to the Indonesian courts for permission to sell the shares in a private sale.

Unfortunately for Beckett, however, it was unable to prove its loss as there was insufficient evidence to back up its assertion that the SME Shares had been sold at an undervalue at US\$800,000. Accordingly, notwithstanding the fact that the court found for Beckett on the point of liability, Beckett was awarded only nominal damages of \$1000.

#### *Whether the Bank could be held liable for breach if no sale at an undervalue is proven*

The Bank argued that Beckett's claim was actionable only upon proof that it had suffered loss. Beckett's failure to prove the alleged undervalue was therefore fatal to its entire case relating to the Bank's duty as a mortgagee.

The court rejected this argument. In Kan J's view, the starting point is that a mortgagee has a duty to act properly when it exercises its right of sale. To discharge that duty, the mortgagee must ensure that it sells the property at a proper price. As such, the Bank ought to have ensured

that US\$800,000 was the proper price for the SME Shares and that its intended mode of sale was appropriate *before* it agreed to sell the shares for that price in a private sale.

*Whether Beckett was entitled to bring a claim in respect of the Asminco, Adaro and IBT Shares*

The court noted that Beckett could not make any direct claim to the Asminco Shares and the Adaro and IBT Shares as these shares had been pledged by SME and Asminco respectively (and not Beckett). Moreover, Beckett did not repay the outstanding Loan and therefore could not claim any right of subrogation.

Having said that, the Bank still owed a duty to Beckett given that Beckett, as guarantor of the Loan, might have been liable for any shortfall between the outstanding Loan and the proceeds from the sale of the Pledged Shares. For this reason, although Beckett had no independent right of action over the sale of the Asminco Shares and the Adaro and IBT Shares, it was entitled to raise *in defence to the Bank's counterclaim* the Bank's failure to preserve and deal with the Asminco Shares and the Adaro and IBT Shares in a proper manner. The onus would then have been on the Bank to show that it had acted with due care when it sold the shares.

As the Bank chose not to call its witnesses at the trial of the action, it failed to prove its counterclaim against Beckett. In any event, as noted by the court, even if the counterclaim had been proceeded with, it would have been difficult for the Bank to demonstrate that it had acted properly in exercising its power of sale since it had not obtained a valuation for the shares and had sold them in a private sale without notice to other potential buyers.

### Comment

The case highlights the need for mortgagees to exercise care and diligence when dealing with mortgaged property. Important precautions include obtaining independent valuations for the mortgaged property and making informed decisions on the mode of sale. Otherwise, mortgagees not only expose themselves to potential claims from disgruntled mortgagors, but may also find themselves barred from recovering any shortfalls from guarantors.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors' Profiles on our website), or either of the following lawyers:

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