

Show me the money

Tim Polli investigates what the last recession can teach us about tackling a boom in lender's litigation

The recession of the late 1980s and early 1990s led to a significant amount of property-related litigation. As property prices collapsed and businesses failed, lenders called in loans and sought to enforce their security, and often discovered that the facts were not as they thought they were. In those cases where lenders suffered a shortfall, they looked to recover that shortfall from their solicitors or valuers and the consequent lenders' litigation continued for much of the '90s.

The initial wave of lenders' claims against solicitors and valuers for negligence was met by various defences. Solicitors claimed the losses suffered by the lenders were not caused by their negligence, and/or that the losses were too remote and/or that the lenders had contributed to their own misfortune by lending imprudently at high loan-to-value ratios. In an attempt to circumvent such defences, lenders incorporated into their claims against solicitors claims for breach of trust or breach of fiduciary duty.

It was uncontroversial that solicitors were acting as agent for their lender clients, and that, pending completion, the lenders' money was held by their solicitors in their client accounts on trust for the lenders. The lenders hoped that, if a breach of fiduciary duty or trust could be proved, the solicitor concerned would be liable to restore the trust fund without any consideration of causation, remoteness or contributory negligence on the part of the lender.

Limited scope

In two seminal authorities, the scope for such arguments was significantly curtailed. First, in *Target Holdings v Redfern* [1995] 3 All 785, the House of Lords clarified that the remedy for breach of trust was not necessarily and automatically restoration of the trust fund; rather, it was equitable compensation such that, if it could not be shown that the breach of trust had caused any actual loss, then no equitable compensation would be payable.

So, on the facts of *Target Holdings*, the solicitor who breached trust by releasing the mortgage advance before the security documents were executed was given leave to defend on the grounds that he had not caused the lender any loss; the security documents were, in due

course, executed and the lender obtained all the security that it had intended to acquire.

Lord Browne-Wilkinson explained: "The basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach.

"I have no doubt that, until the underlying commercial transaction has been completed, the solicitor can be required to restore to client account moneys wrongly paid away. But to import into such trust an obligation to restore the trust fund once the transaction has been completed would be entirely artificial.

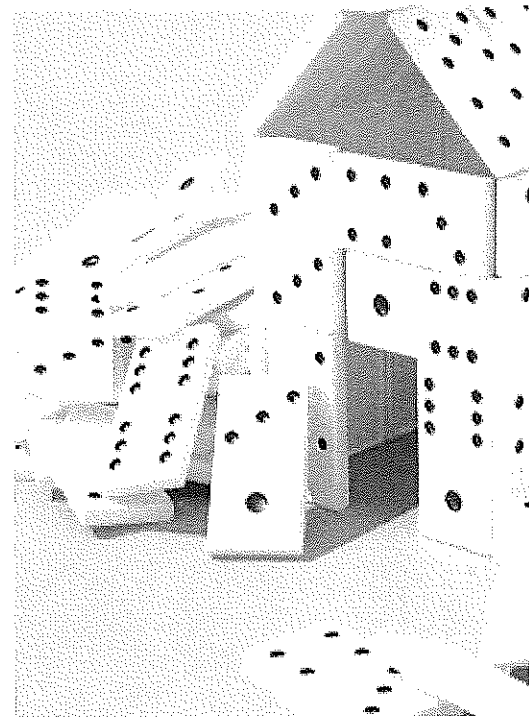
"The obligation to reconstitute the trust fund applicable in the case of traditional trusts reflects the fact that no one beneficiary is entitled to the trust property and the need to compensate them all for the breach. The rationale has no application to a case such as the present."

Second, in *Bristol & West v Mothew* [1996] 4 All ER 698, Millett LJ confirmed that liability by a fiduciary for breach of his duty of good faith required the fiduciary intentionally to prefer the interest of one principal (the borrower, say) over that of another (the lender).

An oversight by a solicitor, caused by failure to exercise reasonable care and skill, could not amount to a breach of the solicitor's fiduciary duty of good faith. Further, liability for breach of trust required the trustee to act in breach of his authority. Accordingly, where the solicitor's failure to exercise proper care and skill had caused the lender to authorise the release of funds, there was no breach of trust.

Although the lender would not have authorised the release of funds had it been properly informed, its authority to the solicitor was voidable, not void, and any subsequent rescission of that authority could not transform a payment which was authorised at the time into a breach of trust.

Millett LJ accepted that, in principle, a client might authorise a solicitor only to release funds once he had properly and fully complied with his instructions, such that any release of funds following a careless breach of his instructions would constitute an automatic (albeit inadvertent) breach of authority and thereby a breach of trust. Such instructions would, he believed,



be most unusual. Clear words would be required and solicitors would be unwise to act on the basis of such instructions.

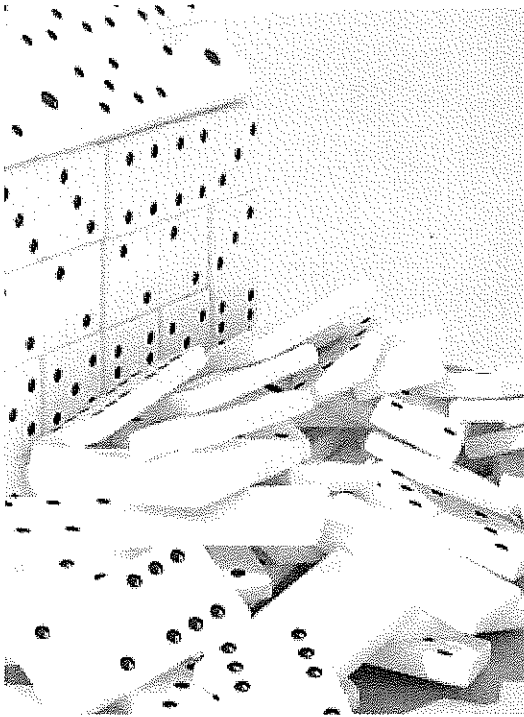
Lost and found

Between them, *Target Holdings* and *Bristol & West* significantly reduced the use of equitable principles by lenders to recover their losses – perhaps more so than they ought to have done. In appropriate cases, however, equitable principles remain powerful weapons and the wave of lenders' litigation arising out of the 2008 recession is likely to test the limits of those principles.

Equitable principles were used by the claimants in the unreported case of *Knight v Haynes Duffell Kentish & Co* [2003] EWCA Civ 223. A solicitor was instructed by his clients, proposed investors in a company, only to release completion monies upon the receipt of shares in the company and the assignment to them of a trademark. They intended then to licence the company to use the trademark. The solicitor released the monies even though the trade name had not been assigned. The investor clients claimed, among other things, repayment of their monies for breach of trust.

The Court of Appeal held that there had been a clear breach of trust when the money was released without an assignment; the release of funds in those circumstances was not within the scope of the clients' authority to the solicitor.

The solicitors firm sought to limit the scope of its liability by relying on *Target Holdings* as authority for the proposition that the remedy for that breach of trust was not reconstitution of the trust fund, but rather to put the claimants into the position they would have been in but for the breach. They argued that the claimants had received the shares in the



company and that the trademark was valueless or of no substantive value and therefore that they were not liable for any substantive payment. That argument was rejected.

The Court of Appeal repeated that passage of Lord Browne-Wilkinson's judgment quoted above and pointed out that the principle in *Target Holdings* only applied where the transaction covered by the trust had been

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completed. They noted that, because there had been no assignment of the trademark, the transaction had never completed. They further observed that the monies released from client account belonged not to one person, but to the three claimants and a fourth person. Finally, the breach of trust was the payment of the monies away and the appropriate remedy was reconstitution of the client account.

Moving on

In the recent case of *Lloyds TSB Bank PLC v Markandan & Uddin* [2010] EWHC 2840 (Ch), the lender claimant succeeded with a breach of trust claim against a firm of solicitors arising out of a residential conveyance.

The solicitor had been instructed by the lender in accordance with the CML handbook which required them to hold the funds on trust for the lender "until completion". In fact, the solicitor released the mortgage advance to the person purporting to be the solicitor acting for the vendor before obtaining either the documents required to complete or a solicitors undertaking that they would be provided.

It transpired that the apparent vendor's solicitor was an imposter and he absconded with the purchase monies. The true owner of the property knew nothing about the transaction. Roger Wyand QC, sitting as a deputy High Court judge, found the authority provided by the CML instructions "entitled the [solicitor] to pay [the funds] away on receipt of the documents necessary to register title or, if paying away before that stage, on receipt of a solicitor's undertaking to provide such documents". Accordingly, there had been a breach of trust.

He found that, by releasing the mortgage advance without receiving a signed contract, transfer and the other documentation, and without checking that the purported solicitors' office existed (in accordance with his CML instructions), the solicitor had not behaved reasonably such that he ought fairly to be excused for his breach of trust pursuant to section 61 of the Trustee Act 1925. Finally, he concluded that there were no grounds to extend the principles of contributory negligence into cases of breach of trust.

The conclusion reached by Roger Wyand QC as to the extent of the authority provided by the CML instructions to a solicitor should,

in principle, be of general application to those cases in which a solicitor was instructed in accordance with the CML handbook. That is, of course, likely to be most cases involving residential conveyances. If so, then there might be some significant consequences of the way that the deputy judge expressed the solicitor's authority in absolute terms.

Where a solicitor believes that he has the documents necessary to complete, but because of a careless oversight on his part he does not, any payment away of the lender's funds would nevertheless be in breach of the lender's authority as determined by the deputy judge in *Markandan & Uddin* and consequently would be in breach of trust.

Further, as the transaction would not have completed, the principle in *Target Holdings* would not apply and the lender would be entitled to reconstitution of the trust fund. Further still, the same would apply where a solicitor reasonably believed that he has the documents required to complete but, in fact, he did not because one of those documents is forged.

There is an obvious issue whether the transaction had completed where, because of

some conveyancing mishap, the lender obtains only a second legal charge, rather than the first legal charge that it expected to have. There is a clear distinction between those cases in which the lender does not acquire title and those in which it does. In the former, breach of trust arguments might enable the lender to recover its money in circumstances where it might otherwise not. In the latter cases, the lender will have security, and its losses are inherently unlikely to be as significant.

However, it is surprising that a negligent solicitor, who might otherwise be able to rely on causation, remoteness or contributory negligence defences or other arguments about the proper quantification of the lender's loss, might, on the same facts, find himself defenceless to a breach of trust claim for the full mortgage advance.

The potential liability of an innocent solicitor, taken in by forged documents, appears even more anomalous, although in such circumstances it should be relatively easy to persuade a court to relieve the solicitor for his breach of trust pursuant to section 61 of the Trustee Act 1925. The burden of doing so would, however, lie with the solicitor.

More pain

Lenders will no doubt scrutinise all the relevant documentation to try to find anomalies or indications of fraud which they will then suggest the solicitor ought reasonably to have spotted such that it would not be fair to relieve the solicitor of his breach of trust.

It might be that liability in such circumstances can be justified by reference to the public policy benefits of spreading the risk of such losses through insurance. However, any widening of solicitors' liability in such circumstances will inevitably lead to further increases in insurance premiums, which will only cause the profession more pain.

It remains to be seen whether the courts will again seek to rein in such liability. In the meantime, lenders are looking to recover their substantial losses from, among others, solicitors' insurers, and *Markandan & Uddin* is a timely reminder that, in appropriate cases, a solicitor may become liable to repay a mortgage advance for breach of trust.

All solicitors with a conveyancing practice should maintain appropriate levels of insurance, and refuse to release any mortgage advance until they are satisfied that they have in their possession all the documents required to ensure that the lender acquires title, or an undertaking from a genuine solicitor that such documents will be provided.

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