IN THE LINE OF FIRE?

Breach of trust and related claims against solicitors

Introduction

1. Earlier this year solicitors up and down the country raised, or certainly should have raised, a glass or two to toast the good health of Lord Sumption JSC, for his judgment in the case of *Gabriel v Little*, or *Hughes-Holland v BPE Solicitors* – whichever you prefer. Either way, the citation is [2017] UKSC 21. In that decision the Supreme Court confirmed that the SAAMCO[1] limitation on liability, which was decided by the House of Lords in the context of negligent valuers, applies to solicitors and other professionals as well. Thus a solicitor's liability for negligence is limited to losses flowing from that particular negligence, and they are not to be held liable for losses flowing from other extraneous factors.

2. The facts in *Hughes-Holland* concerned a failed business venture between a Mr Gabriel and a Mr Little which left Mr Gabriel bankrupt. Following a meeting between the two men Mr Gabriel believed that he was being asked to lend Mr Little £200,000 to redevelop a disused heating tower on Kemble Airfield. As a matter of fact (it was later held) such a project – even if it had been what Mr Little intended – was ambitious, to put it kindly, and downright risky if not unviable, to put it fairly. The position was not, in truth, as Mr Gabriel understood it. Mr Little did not own the building. It was owned by a company that he controlled. It was also subject to a mortgage securing payment of the sum of £150,000. Mr Little's real plan was to have a second company purchase the building from the first, and use that payment to discharge the mortgage. To do so he needed the £200,000 from Mr Gabriel to fund the purchase by the second company. The bulk of Mr Gabriel's was going straight to the creditor bank, and nowhere near the building.

3. In arranging these matters between the two men BPE Solicitors drew up a loan facility letter and a charge. The terms of these documents confirmed Mr Gabriel's mistaken impression that by this transaction he was lending Mr Little £200,000. Without getting too far into the further specific facts of the case, it was on this aspect that liability in negligence against BPE was established as a matter of fact.

[1] See the decision of the House of Lords in *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191.

4. However, the Court of Appeal held, and it was affirmed by the Supreme Court, that the quantum of damages was nil. The court distinguished between cases where a professional acts as an information provider or where he or she acts as an adviser. In the former cases liability will be more narrowly confined. In this particular case it had not been within the scope of BPE's duty to advise Mr Gabriel as to the risks or viability of the project, and the evidence demonstrated that if all had been as Mr Gabriel had understood it was more likely than not to have failed anyway. Therefore the losses he suffered were not attributable to BPE's negligence but to the extraneous factors of his own commercial misjudgement.

5. This important decision will no doubt be well known to you, but I introduce my talk with it because whilst claims against solicitors are made more difficult in this area, one can expect pressure to increase in other ways as claimants seek to test their ability to recover by other routes. In this regard attention is focussed at present on two cases in particular have been recently decided at first instance, and which are due to be heard together on appeal in 2018 – *P&P Property Ltd v Owen White & Catlin LLP* [2017] PNLR 3 ("P&P") and *Dreamvar (UK) Ltd v Mishcon de Reya & Mary Monson Solicitors Ltd* [2016] EWHC 3316 (Ch) ("Dreamvar"). Between them they raise issues as to the potential liability of conveyancing solicitors to their own clients (*Dreamvar*) and to the counter-party (*P&P)* parties where a fraud is perpetrated, and they are concerned with issues of (1) breach of trust, (2) negligence and (3) warranty of authority.

6. Each of these three areas could justify a separate talk, but given the constraints of time and the particular topics suggested by Chris Taylor I propose to focus primarily on the breach of trust angle and the related question of relief under s.61 of the Trustee Act 1925. If time allows I will also touch upon the subject of warranty of authority.

Breach of trust

7. The principle that a purchaser's or lender's solicitor stands as trustee of the monies received and is liable for paying those away on breach of fiduciary duty is now well established. It is also well established that the terms that govern that trust lie in the terms that control the retainer. These instructions can derive from the express terms agreed between the solicitor and the client, by the incorporation of standard lending terms or rules and regulations of the Law Society, or by implication.

8. In *Target Holdings v Redfern* [1996] AC 421 a lender sent funds to the purchaser's solicitors on terms that they were only to be transferred to the purchaser once the property had been purchased and charged to the lender. In breach of those instructions the money was paid over before the charge had been executed. Lord Browne Wilkinson said:

> *This case is concerned with a trust which has at all times been a bare trust. Bare trusts arise in a number of different contexts: e.g. by the ultimate vesting of the property under a traditional trust, nominee shareholdings and, as in the present case, as but one incident of a wider commercial transaction involving agency. In the case of moneys paid to a solicitor by a client as part of a conveyancing transaction, the purpose of that transaction is to achieve the commercial objective of the client, be it the acquisition of property or the lending of money on security. The depositing of money with the solicitor is but one aspect of the arrangements between the parties, such arrangements being for the most part contractual. Thus, the circumstances under which the solicitor can part with money from client account are regulated by the instructions given by the client: they are not part of the trusts on which the property is held.*

9. *Bristol & West Building Society v Mothew* [1998] Ch 1 concerned primarily a claim for negligence, and a secondary claim for breach of trust in respect of providing wrong information as to whether the purchaser were going to take further borrowing to fund the purchase. Millet LJ stated that:

> *It is not disputed that from the time of its receipt by the defendant the mortgage money was trust money. It was client's money which belonged to the society and was properly paid into a client account. The defendant never claimed any beneficial interest in the money which remained throughout the property of the society in equity. The defendant held it in trust for the society but with the society's authority (and instructions) to apply it in the completion of the transaction of purchase and mortgage of the property. Those instructions were revocable but, unless previously revoked, the defendant was entitled and bound to act in accordance with them.*

10. The Court of Appeal re-visited this area of the law more recently in *Lloyds TSB v Markandan & Uddin* [2012] EWCA Civ 65 ("Markandan"). This was a case concerned with a fraudulent sale, in which the lender bank sued their solicitors for paying monies away where both the vendor and the vendor's solicitors firm were bogus. The CML Handbook provides (at clause 10) that solicitors acting for a lender must *"hold the loan on trust for [the lender] until completion"*. As a matter of fact not only did the firm of Markandan & Uddin not wait for the receipt of a transfer document (which, admittedly, would have been forged even if they had) before releasing the money, it actually

released the money on the basis of mere undertakings from the other side – undertakings which were in fact bogus.

11. The Court of Appeal had no difficulty in finding that this constituted a breach of trust. But it also made clear that even had the solicitors waited until "completion" before releasing the money it would still have been a breach of trust had that completion not been *bona fide*. In other words only an effective completion in law would suffice to comply with the terms of the retainer, and anything less would be a breach. Rimer LJ set out what he considered to constitute proper completion in this way:

> *"Completion" in a typical domestic sale and purchase transaction of a property with a registered title conventionally refers to the ceremony, or the agreed postal equivalent, at which the vendor and purchaser (or their respective agents) perform the prior contract. Putting it generally, the purchaser pays money to the vendor, which the vendor applies in redeeming the prior charges and satisfying the unpaid balance of the purchase money. The vendor, in exchange, gives vacant possession of the property to the purchaser and delivers to him the transfer and certificates of discharge of the prior charges. It is this exchange of money and documents that is normally referred to as completion. When, as is usual, the contract incorporates formal conditions of sale, they will specify the "completion date" when these events must be performed (see, for example, in the current (fifth) edition of the Standard Conditions of Sale, conditions 1.1.1(c) and 6.1.1).*

12. He then went on to say that:

> *An exchange of real money for worthless forgeries in purported performance of a contract that was a nullity is not completion at all. Had that happened in this case, the parting with the loan money would have been a breach of trust.*

13. In P&P and Dreamvar the scope of a claim for solicitor's breach of trust was tested but in different ways. In P&P the claimant purchaser made a claim (amongst several others) against the *vendor's* solicitor for breach of trust. In Dreamvar the defendant solicitors (Mishcon de Reya - "MdR") defended its position on the basis that it had released the monies on the basis of undertakings, albeit not proper completion. Both cases, again, concerned a successful fraud perpetrated against the buyer.

P&P

14. In P&P the fraudster impersonated the owner of 52 Brackenbury Road, London W6, and instructed Owen White & Catlin LLP ("OWC") to act on his behalf. OWC did not know that their client did not in fact own the property. The money was received by OWC, paid over to the fraudster, but P&P failed to acquire title. Amongst several other lines of attack the purchaser argued that OWC was liable for breach of trust for releasing the

completion monies in the absence of a valid completion, because the documents wer forged.

15. The court noted that the historical cases did not shed light on a claim made against the other side's solicitors, but accepted the principle that if there were a fiduciary relationship then any question of breach must lie in understanding the terms, if any, on which such trust was governed. In this case it was said that they turned on the terms of the Law Society's Code for Completion by Post 2011. For the defendant solicitor it was argued that these modern terms differed materially from the previous edition of 1998. Where the Code had previously provided that "*...pending completion, the seller's solicitor will hold the funds to the buyer's solicitors order*" in the 2011 version there was no equivalent. In fact there were more detailed but also more limited provisions, e.g. para.10 which provides that:

    The seller's solicitor will complete upon becoming aware of the receipt of the sum specified in paragraph 9...unless (i) the buyer's solicitor has notified the seller's solicitor that the funds are to be held to the buyer's solicitor's order; or (ii) it has previously been agreed that completion takes place at a later time.

16. Mr Justice Robin Dicker QC concluded that these terms did *not* constitute the vendor's solicitor a trustee of the purchase monies pending completion because the Code envisages the receipt of the money and completion as being simultaneous unless otherwise specified. It is prudent to note therefore that the High Court did not reject out of hand the possibility that a seller's solicitor *could* be a trustee for the purchaser. OWC had in fact contended (a) that no trust only arose, and only secondly (b) that if there was the terms of that trust were not breached. The court did not maintain that distinction in its judgment, instead considering that:

    The two claims are interrelated. The question of whether Owen White are liable for breach of trust depends, in part, on the basis on which they received the monies and whether and in what circumstances they were permitted to release them to Mr Harper, which involves, amongst other things, consideration of the Law Society's Code for Completion by Post.

17. It remains to be seen whether OWC will revive the prior argument that no trust arises at all as a separate argument on appeal. Considering the point from first principles it is suggested that the judge's approach was not unreasonable, on the simplified basis that wherever one person receives another's money, whether they be "on the same side" or

on "against each other" it is equitable to inquire upon what terms and upon what basis that transfer was made.

18. Incidentally it may also be that the decision begs the question as to what the position is where the vendor's solicitor holds the purchase monies and, for whatever reason, in breach of the code or without express terms to this effect, the receipt of the money and completion is not simultaneous. This is an issue which is likely to be aired in the Court of Appeal when the appeal in *P & P* is heard in 2018. It may be that the answer to this potential issue lies in paragraph 3 of the 2011 Code which provides that:

> *...the seller's solicitor acts on completion as the buyer's solicitor's agent without fee or disbursement but this obligation does not require the seller's solicitor to investigate or take responsibility for any breach of the seller's contractual obligations and is expressly limited to paragraphs 10 and 12*

Perhaps it is arguable that absent instructions to the contrary at this stage the seller's solicitor act as the buyer's solicitor's agent and so any liability would have to be considered via the rules of agency and relation back to the principal.

Dreamvar

19. In Dreamvar MdR sought to deflect liability for breach of trust on the basis that whilst there had not been completion in the true sense of the word it had nevertheless not been in breach of duty because it had only released the money upon receipt of an undertaking from the vendor's solicitors that the title documents would be forwarded. It is worth noting in this case that the terms of the retainer between Dreamvar and MdR did not expressly provide for the circumstances in which MdR would be authorised to deliver the money to the other side's solicitors, and so to this extent the court was concerned with whether such terms were to be implied into the retainer.

20. The court reminded itself of the recent guidance as to implied terms set out by Supreme Court in *Marks & Spencer Plc v BNP Paribas* [2015] UKSC 72, the primary basis for the implication of a term being that it is necessary to give business efficacy to a contract, or so obvious as to go without saying. The test is objective, and it is a necessary but not sufficient condition that the parties would have agreed it had it been suggested to them. On that basis, and having regard to the decision in Markandan the judge concluded that it was an implied term of MdR's retainer that it would only release the monies upon a *bona fide* completion.

21. It was not sufficient for MdR to rely by way of substitute that (contra the position in Markandan) it had received apparently good undertakings from the fraudster's genuine solicitors. The judge considered that:

In my view, the terms of Rimer LJ's judgment do not support such a distinction. What is required is a genuine completion, not anything less...I therefore conclude that MdR was in breach of trust in paying away the purchase monies to the vendor's solicitor, MMS, in circumstances where there was not, nor could there be, a genuine completion of the contract for sale, which in any event was a nullity.

The present position

22. Pending both these appeals going ahead as planned in 2018, the position at present can be summarised as follows:

(a) A purchaser's/lender's solicitor may liable to his or her own clients in breach of trust for paying monies away in a fraudulent transaction;

(b) A vendor's solicitor may even be liable to the purchaser in breach of trust, for paying monies over to his or her fraudulent client.

(c) Such liability is to be determined by reference to the terms of the retainer between the solicitor and his or her own client, or to the instructions given by the third party to the other side's solicitor.

(d) It is likely to be an express or implied term that payment will only be made on a genuine completion of the conveyance.

(e) It will not be defence that the solicitor has reasonably accepted anything less than completion, unless the terms of the retainer or instructions permit such an alternative.

Trustee Act 1925, s.61

23. Where a solicitor is in breach of the trust of the purchase monies by paying them over to a fraudster, there is protection for the solicitor in the form of s.61 of the Trustee Act 1925, which provides:

If it appears to the court that a trustee, whether appointed by the court or otherwise is or may be personally liable for breach of trust … but has acted honestly and

reasonably and ought fairly to be excused for the breach of trust … then the court may relieve him either wholly or partly from personal liability for the same.

24. The onus is on the solicitor to show that he acted honestly and reasonably. Even an honest solicitor might not be entitled to rely on this "get out" card where there is a breach of the trust on which the loan monies are received and held by him if he has not acted in accordance with reasonable conveyancing practice to verify the identity of the so-called seller. In sympathy with solicitors who are themselves innocent of any fraud and are themselves duped by their client Rimer LJ had this provision clearly in mind in Markandan where he said:

Secondly, it may be thought to be hard on solicitors who are innocently duped by such a fraud that they should be answerable to the lender as trustees. The answer to that turns on s.61 of the Trustee Act 1925, to which I shall return below...

25. On the facts of that case, however, the s.61 defence did not succeed because it was held that the solicitor's conduct had been too poor to allow it to rely upon the statutory discretion. The ideal standard required may be deduced from the one paragraph in which the court dealt with this point (emphasis added):

It is, therefore, the discretionary power under s.61 that provides the key to the claimed unfairness of holding a solicitor liable for breach of trust in circumstances such as the present. ***The careful, conscientious and thorough solicitor, who conducts the transaction by the book and acts honestly and reasonably in relation to it in all respects but still does not discover the fraud****, may still be held to have been in breach of trust for innocently parting with the loan money to a fraudster.* ***He is, however, likely to be treated mercifully by the court on his s.61 application****. M&U's conduct of the transaction was, however, found to fall short of the standard that merited such mercy.*

26. In Dreamvar it was also held that MdR was not able to rely on s.61. The Deputy Judge said (at [187]):

As for MdR's position, it is common ground that it is insured for events such as this, and that its insurance cover is sufficient to cover in full the loss suffered, should it not be excused from liability. In terms of balancing the relative effects or consequences of the breach of trust, it is apparent that MdR (with or without insurance) is far better able to meet or absorb it than Dreamvar. While, as I have held, it was not unreasonable for MdR not to have advised Dreamvar about the risk of fraud, or to have sought greater protection for Dreamvar against that risk (such as further undertakings), it is also not irrelevant that MdR was necessarily far better placed to consider, and as far as possible achieve (a matter not in the event tested), greater protection for Dreamvar against the risk which in fact occurred. As I have already found, Dreamvar has no recourse against MMS, and (it appears) no practical likelihood of either tracing or making any recovery from the fraudster. As a result, the only practical remedy it has is against MdR."

27. With respect to the judge, and I expect that this point is bound to be raised on appeal, it seems to me that he went further in his treatment of s.61 then either the terms of that provision or the gloss placed upon it in Markandan permit. In effect he held that it was simply unfair on Dreamvar and that since MdR were insured anyway that their insurers could pick up the tab. He simply shifted the incidence of the risk from the purchaser to the insurance company. One can only imagine the howls of protest at Lloyds of London. No successful fraud is victimless – the fact that the crook has escaped with his ill gotten gains means inevitably that someone, somewhere is going to have to bear that loss.

28. In this high stakes game of musical chairs statute has provided a get out of jail free card for trustees, if they can show that they have *"acted honestly and reasonably and ought fairly to be excused for the breach of trust*". It seems that the judge has stretched the phrase "ought fairly to be excused" - it is submitted - beyond breaking point, simply on the basis the purchasers only "practical remedy" was against MdR. That is to insert a value judgment as to who ought to be the victim, and is not focussed on what is fair to the solicitor. The fact that it does or does not have insurance is not a matter that reflects on whether it acted honestly or reasonably.

Warranty of Authority

29. If time permits, I will touch more briefly on the issue of warranty of authority. An issue which has arisen on a number of occasions is whether the solicitor who acts for a client is warranting that his client is, in fact, who he says he is. This is a general principle of agency: an agent warrants that he has the authority of his principal by acting on his principal's instructions. The agent who represents that he has such authority is liable to a third party to whom the representation is made if he acts outside of his authority.

30. In *Penn v Bristol & West Building Society* [1997] 1 WLR 1356, a house was jointly owned by husband and wife, Mr and Mrs Penn. Mr Penn decided to take a mortgage to secure a loan to repay some of his business debts, without telling his wife. He instructed a solicitor who mistakenly believed that he was also instructed by Mrs Penn. Unbeknown to the solicitor, Mr Penn forged his wife's signature on the contract documents. Although the solicitor acted wholly innocently, it was held that he was in breach of his warranty of authority, having impliedly warranted that he had the authority not just of Mr Penn but also of his wife. The issue in the appeal was whether that warranty was given not just to the purchaser of the

house but also to the building society and it was held that in the circumstances, it was and the solicitor was liable to the building society for the breach.

31. Conversely, in *Excel Securities Plc v Masood* [2010] Lloyd's Rep PN 165, the lender agreed to lend money to an individual claiming to be "Mr Goulding" which was to be secured on property in his name. In fact, he was an impostor and the lender alleged that he solicitor acting for "Mr Goulding" had given a warrant as to the identity of their client, the borrower, of which they were in breach because he was an impostor. It was held that the solicitors warranted no more than that they had authority to act on behalf of a person identifying himself as Mr Goulding and claiming to be the owner of the property. However, the lender had also carried out certain checks of its own to verify the identity of the borrower.

32. The argument was run by the purchaser in P&P. The Deputy Judge analysed the various cases and distinguished between cases such as *Penn v Bristol & West*, where the solicitor warranted that he had the authority of an individual who had not, in fact, instructed him and *Excel v Masood*, where the solicitor warranted that he had the authority of the person who was instructing him. The issue is as to the extent or terms of the warranty. Does the solicitor merely warrant that he is authorised to act by the actual person who instructs him, or does the warranty go further and extend to the attributes of that person, i.e. a warranty that he acts for Mr X, the owner of Whiteacre? In P&P, the Deputy Judge held that there was no warranty by the vendor's solicitor that he was acting for the actual owner of the relevant property. He said:

> *If [Counsel] was correct to submit, in effect, that a solicitor who acts for someone purporting to sell a property thereby warrants that their client is the registered title holder, solicitors engaged in conveyancing transactions would effectively be guaranteeing that their client was the registered title holder, and would be strictly liable if that was not the case. I have not been referred to anything which suggests that this represents the position as generally understood amongst conveyancing solicitors or others involved in such transactions.*

33. This decision was followed by the Deputy Judge in Dreamvar where an argument was also run that the seller's solicitors were in breach of a warranty of authority, for similar reasons.

34. This is also an issue which is likely to be argued again in the Court of Appeal. It is, perhaps, unlikely that the Court will accept that solicitors acting for a purchaser should assume the role of an insurer in respect of their "client's" entitlement to enter into the transaction, but if the appeal is allowed on this ground, it might open up another avenue for lender's and purchaser's claims against solicitors.

Negligence

35. Having started this talk with reference to good news on the negligence front, I close with a brief warning on this front – and again by reference to an issue that arises in the P&P litigation.

36. The basic ingredient of any cause of action in negligence is to consider the nature of the duty of care. It is trite law that solicitors owe that duty of care to their clients. It is also understood that solicitors, save perhaps in exceptional situations, do not owe a duty of care to the opposite party in a transaction. This is apparent from the decision of Sir Donald Nicholls VC in *Gran Gelato v Richcliff* [1992] Ch. 560. In that case, the solicitor for the buyer, who was taking an assignment of an underlease of a property, raised enquiries of the solicitors for the vendor, asking whether there were any rights affecting the superior lease which might inhibit the enjoyment of the underlease. The solicitors replied that they were not to their knowledge, but that was wrong because the superior lease contained a redevelopment break clause, the exercise of which would bring the underlease to a premature end. The Court rejected the buyer's claim against the seller's solicitor. The Vice Chancellor said:

> *In my view, in normal conveyancing transactions solicitors who are acting for a seller do not in general owe to the would-be buyer a duty of care when answering inquiries before contract or the like.*

37. This decision has been criticised in some textbooks, and it has received mixed judicial treatment. It was referred to with approval by Lord Goff in *White v Jones* [1995] 1 AC 207, and followed in *Frank Houlgate Investment Company Ltd v Biggart Baillie LLP* [2011] CSOH] 160, *LSC Finance Ltd v Abensons Law Limited* [2015] EWHC 1163 and *NRAM Plc V Jane Steel* [2016] CSIH 11. But the Court of Appeal in *McCullagh v Lane Fox Partners Ltd* [1996] 1 EGLR 35 considered that the reasoning in *Gran Gelato* was inconsistent with the rule in *Punjab National Bank v De Boinville* [1992] 1 Lloyd's Rep 7 (CA) and with the general principle of tort where a person doing a relevant act is the agent of another, unless it be the case that *Gran Gelato* stated a special rule applicable only to conveyancing solicitors.

38. In P&P it was argued that *Gran Gelato* was wrongly decided and should not be followed. The complaint was that the "seller's" solicitors (who were not complicit in the fraud) had failed to take sufficient care to verify their own client's identity as owner of the property which was being "sold". The Deputy Judge of the Chancery Division did not comment on whether he thought that the decision in *Gran Gelato* was wrong. Rather, he concluded (at [144]) that it was *"not open to [him]"* to hold that it was wrongly decided. This was, it seems, on the basis

that it had been cited without apparent criticism by the Court of Appeal and had been followed in other cases.

39. It remains to be seen whether the Court of Appeal will follow *Gran Gelato*. If it declines to do so and overrules it, the way could be laid open to bringing claims against solicitors acting for a phantom vendor on the ground that they owe duties not just to their own client but also to the other parties to the transaction.

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