

Breach of Trust...Yet Again!

Paul Butt explains why conveyancing firms dealing with high-value transactions should have strict controls in place in order to avoid being blamed in breach of trust issues.

Introduction

As all conveyancers should know, under CML Handbook clause 10.7, a mortgage advance is to be held by the conveyancer on trust until completion. Liability for use of the monies in breach of that trust is absolute and thus comes without the need to prove fault or negligence on the part of the conveyancer.

There is a defence, however, under section 61 of the Trustee Act 1925, if the conveyancer/trustee acted “honestly and reasonably, and ought fairly to be excused for the breach of trust”. But it must be remembered that a high duty is placed on trustees, particularly professional trustees. Much of the focus of breach of trust cases has been in situations where the conveyancer acting for the lender has paid money over on what they thought was completion, only to receive nothing in return due to fraud – either a fake conveyancer’s office or a fraudster working for a real conveyancer’s firm.

Notable examples include *Lloyds TSB Bank plc v Markandan & Uddin* [2012] EWCA Civ 65, *Nationwide Building Society v Davisons* [2012] EWCA Civ 1626 and more recently *Santander v RA Legal* [2014] EWCA Civ 183.

But a recent decision by the Supreme Court is a stark reminder that the principle of holding the funds on trust pending completion can have a serious and varied impact.

The case

AIB Group (UK) plc v Mark Redler & Co Solicitors [2014] UKSC 58

In 2006, AIB Group (UK) plc agreed to lend Mr and Mrs Sondhi £3.3m to be secured by a first legal charge over their property. The property had been valued at £4.25m. The loan was conditional on an existing first registered charge in favour of Barclays Bank being redeemed on or before completion of the loan. The Sondhis had outstanding borrowings of about £1.5m on two Barclays’ accounts. Solicitors Mark Redler & Co. was instructed to act for AIB and was also acting for Mr and Mrs Sondhi.

Mark Redler obtained the funds from AIB ready for completion. Under the CML Handbook, it therefore held them in trust pending completion of the transaction. As this was a remortgage, for completion to be effected it would be necessary for the solicitors to pay off the outstanding loan to Barclays, ensure the removal of the registered charge and then obtain a first legal charge over the property in favour of AIB.

On completion, the solicitors sent Barclays an amount they thought was the total necessary to redeem the Barclays mortgage, and then sent the balance of the £3.3m mortgage advance, less costs and expenses, to Mr and Mrs Sondhi.

Unfortunately, when they had telephoned Barclays for the precise amount necessary to discharge the existing mortgage, the solicitors had mistakenly been given details of the amount outstanding on only one of the two Barclays accounts secured by the charge.

It is not clear how this happened or whether it was the fault of Barclays or the solicitors. But it did mean that the amount sent by the solicitors to Barclays was approximately £300,000 less than was necessary to cover the balance outstanding on both accounts and thus ensure the redemption of the Barclays mortgage.

As a result, Barclays refused to remove their registered charge from the register of title to the property and AIB could not be registered as a first chargee. Indeed, as there was a restriction on the register prohibiting any further charge being registered without Barclays' consent, Mark Redler could not initially register AIB's charge at all.

Subsequently, when AIB was advised of the problem, negotiations took place between AIB and Barclays. As a consequence of these discussions, AIB executed a deed of postponement acknowledging the primacy of Barclays' charge and Barclays consented to the registration of AIB's mortgage as a second charge.

As if this was not bad enough, Mr and Mrs Sondhi defaulted on their repayments. Their property was eventually repossessed and sold by Barclays in February 2011 for £1.2m.

Out of this AIB, as second charges, received £867,697, approximately £300,000 less than it should have done if the solicitors had remitted the correct amount to Barclays and it had obtained a first charge.

AIB subsequently brought proceedings against the solicitors claiming breach of trust. AIB argued that as Mark Redler was in breach of trust, AIB was entitled to require Mark Redler to reconstitute the entire trust fund, i.e. it was entitled to recover the full amount of its loan, less the £867,697 recovered (approximately £2.5m).

HHJ Cooke, at first instance, found that although the solicitors had acted in breach of trust, AIB could only recover the amount that was mistakenly paid to Mr and Mrs Sondhi by the solicitors, instead of being paid to Barclays (approximately £300,000). The Court of Appeal agreed with HHJ Cooke's decision on the compensation to which AIB was entitled. In doing so, it applied the reasoning of *Target Holdings Ltd v Redfems* [1996] AC 412, a case on similar facts, on the equitable principles of compensation payable in breach of trust cases.

AIB then obtained leave to appeal to the Supreme Court.

Judgment of the supreme court

The Supreme Court unanimously dismissed the appeal. Lord Toulson held that AIB was only entitled to the amount by which it suffered loss (around £300,000). Lord Reed in a separate judgment came to the same conclusion, with reasons substantially the same. Lord Neuberger, Lady Hale and Lord Wilson agreed with both Lord Toulson and Lord Reed.

Having considered the House of Lords judgment in *Target Holdings*, Lord Toulson found that it would be a backward step to

depart from, or re-interpret, Lord Browne-Wilkinson's fundamental analysis of the principles of equitable compensation in that case. A monetary award that reflected neither the loss caused nor profit gained by the wrongdoer, such as the one argued for by AIB, would be penal.

In addition, to argue that AIB suffered a "loss" of £2.5m in this case was to adopt an artificial and unrealistic view of the facts. Rather, he said, one must look at the rationale of the monetary remedy for breach of trust. The beneficiary of a trust is entitled to have it properly administered and is therefore entitled to recover losses suffered by reason of the breach of duty. Here, that loss was the roughly £300,000 that should have been paid to Barclays and would have given AIB a first charge over the property.

In *Target Holdings*, Lord Browne-Wilkinson stated that, "until the underlying commercial transaction has been completed, the solicitors can be required to restore the client account monies wrongly paid away". In the current case, although the solicitors did not 'complete' the transaction in the manner in which it was required, the transaction was, nevertheless, 'completed' as a commercial matter when the loan monies were released to Mr and Mrs Sondhi.

Lord Reed undertook a broader analysis of the relationship between equitable compensation and common law damages. He considered, first, the Canadian Supreme Court case of *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR (4th) 129, focusing mainly on the judgment of McLachlin J.

Lord Reed then considered *Target Holdings*. In that case, Lord Browne-Wilkinson did not intend to say that equitable compensation is

to be assessed in the same way as common law damages. He was not departing from the orthodox view that where a breach of trust occurs, an equitable obligation arises to restore the trust fund to the position it would have been in but for the breach, and that the measure of compensation should be assessed on that basis.

A number of common law jurisdictions have subsequently followed the general approach of McLachlin J in *Canson Enterprises* and Lord Browne-Wilkinson in *Target Holdings*. This is that where trust property has been misapplied, the doctrine of equitable compensation requires the trustee to restore the trust fund, or, where the trust has ended, to pay to the beneficiary a sufficient amount to put the beneficiary in the position it would have been in if the trustee had performed his obligation.

Despite structural similarities, when assessing equitable compensation and common law damages, liability of a trustee for breach of trust is not generally the same as liability in damages for tort or breach of contract. The nature of the obligation breached, and the relationship between the parties, affect the measure of compensation.

In the present case, AIB's argument was based on three fallacies: (i) it assumed that the solicitors misapplied the entire £3.3m as opposed to approximately £300,000. The judge took the view that it was only the £300,000 that was misapplied; (ii) it assumed that the measure of the solicitors' liability was fixed at the date of the breach of trust; and, (iii) it assumed that liability does not depend on a causal link between breach of trust and loss.

Points (ii) and (iii) were rightly rejected in *Target Holdings* and would be rejected by the Supreme Court also. AIB should only be able to recover its loss, which was approximately £300,000.

Comments

It does seem strange that the lenders in this case lent £3.3 million on property that was valued at £4.25 million, yet turned out to be worth only just over £1 million. Obviously, valuation is not an exact science, but could a property have fallen so much in value even in the recession? Presumably, it was much easier for AIB to sue the conveyancer rather than contemplate action against the valuer.

Also, the wisdom of obtaining a redemption figure by telephone is questionable, particularly in a transaction of this size.

A figure given in writing would presumably have made it much easier to ensure that the figures related to both accounts.

Of course, sometimes matters must be completed in a hurry, so no criticism of the solicitors is intended. But in this risk aware world, why should a solicitor be expected to take on additional risks to carry out the client's instructions because they want things doing in a hurry?

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