A matter of discretion

Francesca Kaye & Mary Hodgson offer some hope for solicitors pursued for breach of trust

A number of lenders are seeking to reduce losses sustained after the sale of repossessed properties by pursuing breach of trust claims. This may be because solicitors are perceived to have deep pockets, but with no deduction for contributory negligence, breach of trust claims can also avoid close scrutiny of lending policies and mortgage applications.

There have been several recent decisions of note on the application of s 61 of the Trustee Act 1925, as well as consideration of what constitutes a breach of trust. These are covered briefly below along with the decision in *Nationwide Building Society v Davisons Solicitors (a firm)* [2012] EWCA Civ 1626, which offers some hope to firms pursued for breach of trust in the event of being involved (however inadvertently) in a fraud.

Completion & breach of trust

The *Council of Mortgage Lenders' Handbook for England and Wales* establishes at cl 10, that completing solicitors acting for a lender "must hold the loan on trust for us until completion". What constitutes completion was considered in *Lloyds TSB Bank Plc v Markandan & Uddin* [2012] EWCA Civ 65. Mr Roger Wyland QC determined that completion occurs "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". This was approved by the Court of Appeal. Any payment of monies before receipt of the necessary documents or an undertaking to provide such documents would therefore be a breach of trust. This was confirmed in the case of *Mortgage Express v Iqbal Hafeez Solicitors* (a firm) [2011] EWCA 3037 (Ch).

In *Markandan*, completion monies had been exchanged for an undertaking given by a firm who had already breached an earlier undertaking. In *Iqbal Hafeez* the court found that the undertaking given should not have been relied on because Iqbal Hafeez had not verified whether or not the firm giving the undertaking was a genuine firm (it was not). These were both found to be breaches of trust.

In both cases, the actions of the solicitors were considered and found to be unreasonable. Section 61 relief was not available and the firms were held liable for the lenders' losses.

Davisons: a glmmer of hope

The case of *Nationwide Building Society v Davisons Solicitors (a firm)* was similar to *Markandan*: the defendant acted on behalf of the purchaser and lender, checked the existence of the vendor's solicitor and branch office with the Law Society and the matter proceeded normally other than that the requisitions on title were sent back in non-standard format.

The vendor's solicitors confirmed that the prior charge would be discharged at completion and that they would comply with the Law Society's code for postal completion. Paragraph 9(ii) of that code provides that the seller's solicitor undertakes to redeem or obtain discharges of existing registered charges.

However, although the solicitor named was a genuine solicitor practising at the firm, the branch office had never existed. The details on the Law Society website had been submitted by someone apparently involved with the fraud.

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Upon completion the first legal charge was not discharged and the vendor's solicitors disappeared with the money. A charge had been executed, but could not be registered. The lender did not, therefore, gain the security it had expected in exchange for the monies released. The lender brought proceedings against its solicitors, Davisons, for breach of trust.

At first instance Ms Catherine Newman QC determined that by failing to obtain an explicit undertaking to provide the documents necessary to register title, Davisons had acted in breach of trust when they paid the completion monies away. The Court, applying *Markandan*, found that by so acting, Davisons acted unreasonably and that no relief would be available under s 61. Davisons appealed and the Court of Appeal handed down judgment on 12 December 2012.

In the leading judgment, the Chancellor of the High Court determined that compliance with para A3.2 of the CML Handbook, including checking the existence and legitimacy of the vendor's solicitors was not sufficient to provide authority to pay completion monies away without completion (as defined in *Markandan*) occurring. To do so constituted a breach of trust.

The Court of Appeal concluded that the replies to requisitions on title, in conjunction with the adoption of the Law Society's code for postal completion, constituted an acceptable undertaking to redeem the prior charge. It went on to find that Davisons had acted reasonably in the circumstances and that they should be entitled to s 61 relief.

The loss was caused by a fraudster: even if Davisons had insisted on replies to requisitions on title in the standard format and separate undertakings stating that the charge would be discharged, it is probable that they would have been provided. However, the end result would have been the same: the charge would have remained on the title and the money would have disappeared. The departure from best practice by Davisons did not cause the loss. Therefore the discretion to grant s 61 relief was exercised in favour of Davisons.

Bucking the trend

The trend of recent decisions in similar cases was somewhat in favour of lenders. The courts had been taking a robust approach to compliance by solicitors and not exercising discretion in their favour or granting s 61 relief.

However, the Court of Appeal in *Davisons*, despite the solicitors' failure to comply with their instructions, exercised discretion in the solicitors' favour. Whether it was simply because the court took the view that no matter what the solicitors had done, the lender would have been defrauded or whether this is evidence of a change of approach remains to be seen.

For the moment this case should provide some comfort for solicitors, and their insurers, who are inadvertently and innocently caught up in fraud. **NLJ**

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