

# Breach Of Trust Revisited: Some Good News...and Some Bad!

The problem of fraudsters setting up fake law firms - and the liability of genuine firms dealing with them - has once again been reviewed by the Court of Appeal. Paul Butt examines the latest position.

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## **Remember Lloyds TSB Bank plc v Markandan & Uddin [2012] EWCA Civ 65 and Nationwide Building Society v Davisons [2012] All ER (D) 141?**

In both of these cases mortgage loans obtained to buy property were sent by the lenders' solicitors to fake branch offices purportedly acting for the sellers. The solicitors thought that they were completing the purchase in the usual way, but the fraudsters just disappeared with the cash. The lenders were not best pleased at losing their money and sued their solicitors.

The solicitors were held to be liable. When a conveyancer receives the mortgage advance from the lender prior to completion, it is held on trust for the lender pending 'completion'.

But, of course, completion never took place and so the conveyancer is potentially liable to return the monies handed over in breach of trust. The only defence available to the conveyance is under s 61 of the Trustee Act 1925. This gives the court discretion to exclude liability if the trustee (i.e. the conveyancer) has acted 'honestly and reasonably'.

Obviously, there was no question of the lender's conveyancer having acted any way other than honestly, but had they acted reasonably? In Markandan & Uddin the fake branch office had not been registered on the SRA Find a Solicitor website. However, in the Davisons case, the fake branch office had been registered – but the firm was still held to have not acted 'reasonably'. The good news is that an appeal in the Davisons case has now been granted by the Court of Appeal (see [2012] EWCA Civ 1626).

## **The Facts**

The facts of the Davisons case are worth repeating. In 2007, a solicitor, G, established a legitimate and registered solicitor's practice. In 2008, a fraudster, pretending to be G notified the SRA of an intention to open a second branch – a fake branch! The SRA was deceived, and placed the fake branch on its records.

The legitimate firm learnt of the deception and advised the SRA in December 2008. However, it was only in April 2009 that it removed the fake branch office from its records and website.

In November 2008, the buyer applied to the claimant for a loan secured by mortgage for the purchase of a property. When the application was approved, both the buyer and the lender instructed Davisons. The matter was dealt with by DW, a solicitor and experienced residential conveyancer.

The lender expressly provided that its instructions were on the basis of the current version of the Council of Mortgage Lenders (CML) Handbook. It was an express term of those instructions that the loan was to be secured by a first legal charge over the property and that all existing charges had to be redeemed on or before completion.

The fake branch purported to act for the vendor. DW had not dealt with the fake branch and therefore as warned by the Law Society made the required checks to confirm it was genuine. He checked both the legitimate office and G. His investigations confirmed G to be a solicitor and a sole practitioner and the existence of both the legitimate branch and the fake branch.

Matters proceeded to completion along usual lines. There was a prior charge on the property to another lender, GE money. On 4 March 2009, the lender released the mortgage money to Davisons. This was to be held on trust for the lender on the express terms of the retainer.

Under the CML Handbook, the advance is to be held on trust 'until completion' (paragraph 10.3.4). The transaction was purportedly completed, it having been agreed that completion would take place under the terms of the Law Society Code for Completion by Post.

However, Form TA13 - which is usually completed by a seller's conveyancer prior to completion and contains express undertakings to discharge an outstanding mortgage - was not completed by the fraudster.

The defendant paid the loan money into the bank account notified by the fraudster. In reality, the property was still subject to the pre-existing first charge which was not discharged on completion or subsequently and the mortgage was not registered in favour of the claimant.

The claimant issued proceedings against the defendant seeking damages for breach of contract or an order for the restoration of a trust fund and for equitable compensation.

The issues were, inter alia: (i) whether the defendant was in breach of the terms of the retainer; (ii) whether the defendant was in breach of trust. In the event that the defendant was held to be in breach of trust, the issue was whether the defendant should be relieved from all or any of the consequences of that breach by the exercise in their favour of the court's powers under s 61 of the Trustee Act 1925.

The claimant opposed the grant of any relief under that section because of the defendant's failure to notice 'suspicious' features in the correspondence (see [47] of the judgement) particularly that neither Form TA13, nor any other document, contained anything capable of being construed as a solicitor's undertaking to discharge the first charge on completion.

### **The High Court Decision**

Catherine Newman QC held that the defendant should have obtained an undertaking from a solicitor to redeem or obtain a discharge for the charge. The defendant did not have those undertakings and was therefore in breach of trust in parting with the advance (see [44] of the judgment). The power under s 61 was a discretionary power that provided the key to the possible unfairness of holding a solicitor liable for breach of trust (see [45] of the judgement). It had been insufficient for the solicitor to proceed as he had done without

clearly worded undertakings. A careful and diligent solicitor would expect to be clear in his own mind that he had an express undertaking on a matter so important. Relief under s 61 of the Act was therefore refused (see [50] of the judgement).

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### **The Court of Appeal Decision**

The Court of Appeal unanimously disagreed with Catherine Newman QC. The solicitor acting for the lender had throughout acted honestly and reasonably and had obtained the benefit of an undertaking due to the agreement to complete using the Law Society Code for Completion. The Code contained an implied undertaking to discharge the existing mortgage and this was sufficient. Even if the Davisons had insisted on answers to requisitions on form TA13 and on separate written undertakings it is probable that the impostor would have complied, the matter would have proceeded to apparent completion by post and the impostor would still have disappeared with the balance of the purchase money. The lapse from best practice, if any, did not cause the loss to Nationwide.

### **Good News**

So good news for conveyancers – and their insurers! Particularly reassuring is the comment (in paragraph 48) by the Chancellor that “The section only requires Mr W... to have acted reasonably.

That does not, in my view, predicate that he has necessarily complied with best practice in all respects. The relevant action must at least be connected with the loss for which relief is sought and the requisite standard is that of reasonableness not of perfection”.

Bad news However, it is not all good news. Since the case was heard at first instance, the SRA has published a warning notice for solicitors about 'Bogus Law Firms'. This is not widely known, but needs to be – it is available both on the SRA website and in The Law Society Conveyancing Handbook.

Please read it now! The problem is that as well as raising awareness of the issues of bogus law firms and fraud, it contains the following warning: You should check the Find a Solicitor website since there are sometimes bogus law firms which have not sought registration with the SRA and will not appear there; but bear in mind also that the nature of identity theft is that fraudsters may have obtained some form of registration by fraudulent misstatement to the SRA and therefore an entry on Find a Solicitor should not be taken as verification that the firm is genuine.

Cynics might say that this is a move by the SRA to cover its back against any possible claims against it for registering fake firms! But does this mean that in future, a firm misled by entries on Find a Solicitor, could still be held liable to the lender for breach of trust? Presumably so, if there were any other 'suspicious circumstances' in the particular transaction.

The SRA Warning Notice contains a list of matters to look out for which might be an indication of a fake firm. These should be studied carefully by all fee earners. They are as follows:

- a. Errors in letter heading—in one case the bogus office had letter heading which misspelt the name of the town in which it was supposedly based;

- b. No landline telephone number—note that numbers beginning with 07 are mobile telephone numbers;
- c. Inconsistent telephone or fax numbers with those usually used by the firm;
- d. Telephone calls being diverted to a call-back service;
- e. A firm apparently based in serviced offices;
- f. Email addresses using generic email accounts—most law firms have addresses incorporating the name of their firm; if in doubt, check the genuine law firm's website to identify its contact email address. You may well notice a difference;
- g. Sudden appearance in your locality of a firm with no obvious connection to the area, probably not interacting with other local firms at all;
- h. A firm appearing to open a branch office a considerable distance from its head office for no obvious reason;
- i. A firm based in one part of the country supposedly having a bank account in another part of the country—this is a strong indicator and has been seen several times;
- j. A client account apparently overseas—this is a breach of rule 13.4 of the SRA Accounts Rules and is a major red flag;
- k. A strange or suspicious bank account name—such as the account not being in the name of the law firm you are supposedly dealing with either at all or by some variation.

But note also the warning: These do not necessarily individually establish a serious problem but are factors to be considered. In particular, one can think of many reputable conveyancers based in one part of the country and having a bank account elsewhere!

Even more worrying is the paragraph that warns firms as to how they might protect themselves against someone setting up a fake branch office of their firm:

*Bear in mind that you may come across these frauds in different contexts. Of course, you must keep an eye on any indication that your firm is being targeted or its name being used improperly.*

*If you discover this, you should contact the SRA and your insurers, including consideration of legal action such as by way of injunction either to stop misleading statements or to freeze assets if money has gone missing. If there is any evidence of a crime having been committed, you should also inform the Police. Some practical things you can do:*

- a) *Search your firm's name on the internet from time to time, since that might bring up a false office - it may be worth considering doing the same with the names of some of your partners or staff;*
- b) *Check your firm and individual details on the Law Society's Find a solicitor web page - in case someone has misused your name to set up a false office;*
- c) *Be alert to suspicious incidents such as transactions that others seem to think your firm is dealing with when you are not*

So, presumably, in future, if firm A has a fake office established in its name, and firm B loses money because of this, firm A could potentially be liable to a claim from firm B if they have not taken adequate steps as set out in the Warning Notice. Conveyancing does not get any easier, does it?

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