Chancery & Commercial

Case Law Update

Winter 2014

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Landlord and Tenant

Circle Thirty Three Housing Trust Limited v Nelson [2014] EWCA Civ 106

Hidden away amongst all the post-*Mitchell* hysteria is a useful Court of Appeal decision which confirms the jurisdiction of the Court to grant relief of its own motion and without reference to a substantive application and complying with the usual requirements of CPR r3.9. That jurisdiction was previously set out by Moore-Bick LJ at paragraph 35 of the judgment in *Marcan Shipping v Kefalas [2007] 1 WLR 1864*:

"…the party in default must apply for relief from the sanction if he wishes to escape its consequences. Although the court can act of its own merit, it is under no duty to do so, and the party in default cannot complain if he failed to take appropriate steps to protect his own interests."

In summary, the case before the Court was a claim for possession brought by a social landlord against its tenant on the basis that the tenant was in breach of the tenancy agreement by reason of her failure to live at the property as her only or principal home. The tenant disputed the allegation. An order for specific disclosure was made against the tenant in respect of bills and credit cards which would assist as to the residence issue. The tenant disclosed some, but not all, of the documents and an unless order was therefore made requiring disclosure of the outstanding documents, failing which her defence would be struck out. The tenant failed to comply and, at the hearing below, the Court granted a possession order in light of the tenant-representative's muddled explanations for non-compliance on the grounds that the bank had failed to respond and also that the relevant account had in fact closed.

On appeal, further evidence became apparent that the tenant had taken all reasonable steps to obtain the outstanding documents from the bank and it was in fact the bank who was at fault. The Court took the view that the fresh evidence was material to the issue of compliance and would have made a difference to the Court's decision below. Rather than remit the case for a formal 3.9 application to be made, the Court, without reference to *Mitchell*, took the view that it would be proportionate for the Court to exercise its inherent jurisdiction outlined in *Kefalas* and to grant relief of its own motion on the basis of the material available to it. The appeal was therefore allowed, the defence restored and the possession order set-aside with the case remitted to the County Court for case management for a trial of the issues.

The decision therefore serves a useful reminder that, in appropriate cases, the Court can, and should, act of its own motion and grant relief without there being a formal 3.9 application before the Court.

Gary Lewis

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Wills & Trusts

Loring v Woodland Trust [2014] EWCA Civ 1314

In the previous edition of this Newsletter the decision of Asplin J in *Loring v Woodland Trust [2013] EWHC 4400 (Ch); [2014] W & TLR 593* was discussed. The case concerned a will (written before the *Finance Act 2008* enabled spouses to transfer on death their unused nil-rate bands) whereby a testatrix bequeathed legacies equal to her "nil-rate band" to family and friends and the residue to charity. The issue was whether the nil-rate band legacy was to be calculated ignoring the transferable nil-rate band from the testatrix's husband's estate which would give the family and friends £325,000 and the charity £355,805 or including the transferable nil-rate band which would give the family and friends £650,000 and the charity £30,805. Asplin J decided that the latter was the correct construction.

The charity appealed, but the Court of Appeal (Christopher Clarke and Lewison LJJ and Sir Colin Rimer) affirmed the decision of Asplin J. Both Sir Colin Rimer and Lewison LJ gave full judgments.

All three Judges were deeply troubled by the fact that the amount of a legacy could depend upon the exercise of a discretion by the executors to claim the benefit of the transferable nil-rate band, but none of the Judges held that the executors acted wrongly or gave any guidance as to how executors should exercise their discretion whether or not to claim the unused nil-rate band of the testator's spouse.

Ultimately all three Judges dismissed the appeal because of the difficulty in ascribing a meaning to "my unused nil rate band" other than a literal meaning. As the testatrix did not use a specific sum, she clearly anticipated that the size of the legacy would vary with changes in tax rates and her own situation. Lewison LJ further stated that the testatrix wished to give as much to her family and friends as she could without any Inheritance Tax becoming payable.

None of the judgments in the Court of Appeal paid great attention to the precise wording of the will and situation of the testatrix and the judgment is of general application. (The charity presumably would not have appealed if the case were thought to turn solely upon the precise wording of the will.) Unlike Asplin J, Lewison LJ stated that he found the Revenue's guidance upon the issue unhelpful and he did not endorse it (*para 41*).

The general observations made in the previous Case Note can usefully be repeated with the addition of a fifth. They are:

(a) Practitioners should check the precise wording of nil-rate band legacies in their templates for wills and should include in a letter of explanation to testators a full explanation of the effect of the particular nil-rate band legacy;

(b) Consideration should be given to the suggestion of James Kessler that nil-rate band legacies should have a maximum monetary sum. This will be important if the nil-rate band is very substantially increased, as has been proposed in some quarters in recent years;

(c) Practitioners should encourage clients to review their wills at regular intervals to ensure that they reflect the current Inheritance Tax regime (a 5-yearly MOT for wills?);

(d) Where a personal representative is considering whether to elect to claim a transferable nil-rate band, and the wording of the nil-rate band legacy is such that claiming the transferable nil-rate band will have a greater effect upon the relative entitlement of beneficiaries than the saving of Inheritance Tax, he should consult the beneficiaries affected before making the election in order to obtain their consent to any particular course. If consent is not forthcoming, he should seek the directions of the High Court;

This is an area where there is sufficient ambiguity that extrinsic evidence of the testator's intention should be admissible under *Section 21(b),(c) Administration of Justice Act 1982* and this may lead to a contrary result from that put forward by the Court of Appeal.

Richard Oughton

Sale & Rent Back

Southern Pacific Mortgages Ltd v Scott [2014] UKSC 52; [2014] 3 WLR 1163

In recent years the activities of firms which offer to buy houses from their financially distressed owners and then rent the houses back to the owners have caused concern. Typically the owner is elderly and not financially sophisticated and burdened with secured and unsecured debt, which they cannot (or believe that they can not) repay. An offer of an arrangement whereby the debts are discharged and the vendors can continue to live in their houses appears very attractive. However, in very many cases the arrangements have proved to be disastrous for the vendors in that:

(a) the terms offered generally are unfavourable with the nominal price of the property being much less than the market value;

(b) the tenancy to the vendor is undocumented and its terms not always certain;

(c) the purchaser funds the purchase from a mortgagee who does not know of the arrangement and is at best only agreeable to the property being subject to a 6-month Assured Shorthold Tenancy.

In the important County Court decision of *Redstone Mortgages PLC v Welch [2009] 3 EGLR 71*, it was held that the vendor's rights as against the purchaser bound the mortgagee because the vendor was in "actual occupation" of registered land and hence had an overriding interest within *paragraph 2 of Schedule 3 to the Land Registration Act 2002*.

The matter again arose for decision in a series of cases arising from the failure of a firm specialising in such purchases in the North East of England. A series of preliminary issues were ordered to be tried in Leeds before H.H. Judge Behrens sitting as a Judge of the Chancery Division. Judge Behrens refused to follow *Redstone Mortgages PLC v Welch* and held that the mortgagees took free of any rights of the vendors (*[2010] EWHC 2991(Ch)*).

The vendors appealed to the Court of Appeal. In a unanimous decision the Court consisting of Lord Neuberger MR, Rix and Etherton LJJ, dismissed the appeal with a single judgment being delivered by Etherton LJ (*[2011] EWCA Civ. 17; [2012] 1 WLR 1521*). Many practitioners found aspects of the judgment of the Court of Appeal, particularly Etherton LJ's reliance upon the vendors being estopped by reason of the form of the transfer, unconvincing and it was no surprise that the Supreme Court gave permission to appeal.

The Supreme Court has now dismissed the appeal of the vendors (*[2014] UKSC 52; [2014] 3 WLR 1163*). There were two judgments, the minority judgment of Lord Collins of Maplesbury with whom Lord Sumption concurred and the majority judgment of Lady Hale with whom Lords Wilson and Reed concurred. It may be noted that none of the five judges had any particular background in property law. That seven months elapsed between argument and judgment might suggest that there had been disagreements within the Court and that the Judges found aspects of the case particularly difficult.

The vendors could not put their case upon a classic sale and leaseback leading to an equitable lease because of uncertainty as to the terms of the tenancy and because there was no writing to satisfy *s2(1) Law of Property (Miscellaneous Provisions) Act 1989*. Instead the vendors put their case upon either a constructive trust (*Bannister v Bannister [1948] 2 All ER 133*) or proprietary estoppel and this was readily accepted by the Supreme Court.

Both judgments in the Supreme Court held:

(a) that an overriding interest could only be created by a person who himself had an interest in land and that a person could not create an interest in land before he himself acquired an interest in land;

(b) that a sale and mortgage used to secure the monies used in the purchase of the property were to be treated as one transaction and that accordingly there was no

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> *scintilla temporis* when the purchaser could create interests binding on the mortgagee. In short all a vendor acquired was an equity of redemption.

In doing so the Supreme Court followed the decision of the House of Lords in *Abbey National BS v Cann [1991] 1 AC 56*.

The division in the Supreme Court concerned the effect, if any, of any contract of sale preceding the transfer. In the actual decision there was a simultaneous exchange of contracts and completion and both leading judgments held that in such a situation the contract was to be treated as part of the same transaction as the transfer and mortgage. However, Lord Collins in unconvincing and deeply troubling passages went on to opine that this would always be the case. In reliance solely upon a recent academic argument, he appeared to reject the contract as giving rise to equitable property rights. A more orthodox and correct approach was given by Lady Hale who held that where the contract was not simultaneous with the transfer, equitable property rights potentially binding a purchase money mortgagee could be created. There seems no good reason why a sub-purchaser should not be able to protect his rights under the system of land registration. Although with improvements in conveyancing law and practice, the importance of contracts has diminished since 1925, the contract of sale as a source of property rights and obligations not found in any transfer or conveyance remains the cornerstone of much of English conveyancing law. (Significantly Lady Hale's second husband, Professor Farrand, made his academic reputation with a book entitled "*Contract and Conveyance*")

The case does highlight a weakness in both unregistered and registered land and that concerns the possibility of rights arising after an initial inspection of the title, it being not necessarily practical to inspect the title upon the day of completion. With land charges and entries on the registered title, this was solved by priority notices. However, with equitable notice arising from being in possession of the land and overriding interests arising from being in actual occupation, there is very little which a purchaser or mortgagee can do to detect a person who goes into occupation immediately prior to completion or a person already in occupation acquiring rights after an initial inspection. (In *Abbey National BS v Cann* the issue concerned a possible occupation for 35 minutes prior to execution of the Transfer.) Lady Hale was aware of this point, but expressed the view that the statutory language should be followed even if it led to unreasonable results (*para 102; [2014] 3 WLR 1189E-G*).

Because the Supreme Court was concerned with the trial of particular preliminary issues, the Court did not concern itself with the possibility of the mortgagees relying upon subrogation. There seems no good reason why the mortgagee should not be subrogated to the vendor's mortgages discharged as a result of the transaction, although frequently the purchase money mortgage is significantly greater than the existing secured charges. The existence of the possibility of a mortgagee being subrogated to existing charges as a result of the transaction has in the past led legal advisers of vendors not to challenge the rights of mortgagees in such transactions. In

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any event it is arguable that the underlying ratio of *Abbey National BS v Cann* is subrogation.

As Lord Collins noted in his judgment, "sale and rent back" arrangements are now regulated by under *s9 Financial Services and Markets Act 2000*. This regulation has led to the industry virtually ceasing to trade. The judgment of the Supreme Court remains important for:

(a) existing transactions. The unsatisfactory nature of many transactions has been hidden by low interest rates, but may well be revealed if interest rates rise;

(b) one-off transactions between members of the same family and friends.

The judgments of the Supreme Court are interesting for a discussion in outline of the liability of the solicitors acting for the vendors and the mortgagees respectively. In the specific case before the Supreme Court the purchaser said to the vendor that he would pay the vendor's legal costs if she used a particular firm recommended by him (*para 16; [2014] 3 WLR 1169B*). This was not untypical of such arrangements and solicitors so acting might reasonably be thought to be more motivated by the prospect of many repeat instructions than by acting in the best interests of the vendor. Lord Collins (the only solicitor member of the Supreme Court) described the behaviour of the solicitors acting for the vendor as *"unprofessional and dishonest"* (*para 24; [2014] 3 WLR 1170A-B*).

The duties which a solicitor owes a vendor in such situations would appear to include the following:

(a) While a solicitor does not owe a financially astute client a duty to advise upon the merits of a transaction (*Jackson and Powell, Professional Negligence 7th ed para 11-169*), such a duty is probably owed to a financially unsophisticated client. There should at the very least be a duty to advise a vendor to have the property professionally valued. A one-minute internet search of the values of neighbouring properties should be sufficient to set alarm bells ringing if the price offered is significantly below the market price;

(b) A solicitor should ensure that a tenancy agreement in accordance with his instructions is drawn up and executed. Further, the solicitor should refuse to complete unless he can ascertain that the purchaser will not mortgage the property or, if the property is to be mortgaged, that the tenancy will be binding upon the mortgagee.

A solicitor acting for a mortgagee whose instructions extend to obtaining vacant possession is in breach of duty to the mortgagee if he releases the mortgage advance when he knows that vacant possession is not being obtained (*para 118; [2014] 3 WLR 1194B-D*).

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The premise of the BBC Television programme "*Hustle*" was that *"you cannot con an honest man"*. While this may not be true of life in general or the majority of sale and rent back transactions, in my experience it does have some relevance to a significant number of sale and rent back transactions. A significant number of vendors entered into these transactions in the hope that, having dissipated their assets, they will have their rent paid by Housing Benefit. The cases before the Supreme Court were fought on preliminary issues and there was no suggestion that the vendors involved were so motivated. However, it must not be assumed that all vendors in such situations are totally innocent.

In the cases before the Supreme Court, the firm organising the scheme used nominee purchasers for each purchase, presumably to hide from the mortgagees the real nature of the transaction. These nominee purchasers now find themselves personally liable on the mortgage covenants to the mortgagees and possibly also personally liable to the vendors. Because of the way in which the litigation was fought by way of preliminary issues, there was no investigation of whether the mortgagee's surveyors or brokers had any inkling of what was really happening (a broker being in law the agent of the borrower, but often being paid commission by and having close links to the lender). One does wonder whether in a profession which depends upon being aware of other transactions, at least one property professional acting directly or indirectly for the mortgagee did not know what was going on.

As Lady Hale observed, the facts in *Abbey National BS v Cann* were different from the facts in the present case (*para 122; [2014] 3 WLR 1195G-1196A*) and it would not have been unreasonable for that case to be distinguished in the present case. That the Supreme Court chose not to go down that route might reflect a desire to make conveyancing as simple and as cheap as possible (a matter referred to by Lord Collins at *para 25; [2014] 3 WLR 1170B-C*). It is clearly conceivable that, had the decision gone the other way, the practice whereby purchasers and mortgagees instruct the same solicitor which saves a great deal of money, would have to end. An extreme response to a contrary decision in the Supreme Court might have led to mortgagees having to send agents to houses to check that no-one was in occupation at the precise moment of completion. The Supreme Court was entitled to take into account that regulation has substantially remedied the problem prospectively and that vendors are not without a remedy against their own solicitors. Furthermore subrogation in many cases would mean that the vendors' chances of staying in their houses for the rest of their lives were remote.

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Banking / Fraud in CHAPS Transfers

Tidal Energy Ltd -v- Bank of Scotland PLC [2014] EWCA Civ 1107

The Claimant sought to pay a creditor some £217,000. However, a fraudster supplied the Claimant with his own bank account details rather than those of the true creditor. When the Claimant completed a CHAPS payment form with its bank (the Defendant), it filled in the details of the fraudster.

The Bank's standard CHAPS form required to be completed to state the beneficiary's name, bank, sort-code and account number; and the Claimant filled in these details as provided to it by the fraudster. The Bank then transferred the money to the fraudster's bank; which transferred it into the fraudster's account; whereupon the fraudster withdrew it before the fraud came to light.

The Claimant sued the Bank to recover the money, arguing that the Bank was in breach of contract in failing to carry out its instructions to pay the creditor. The Bank defended the claim, arguing that it had done all that was required of it, and had acted in accordance with the CHAPS Scheme Rules. It said that banking practice was to transfer funds to the branch with the stated sort-code, and thereafter into the stated account; but that the name of the account holder would not be checked, as to do so in every case would be time-consuming and defeat the objective of CHAPS.

At first instance, the Judge accepted the Bank's evidence as to banking practice, and found that there was no breach, dismissing the claim.

On appeal, the Court of Appeal upheld that decision by a majority. The Master of the Rolls quoted Lord Steyn in *Mannai v Eagle Star* – "*In determining the meaning of the language of a commercial contract […] the law […] generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them,*" – and held that the construction contended for by the Claimant would produce a result which was "*not reasonable and not commercially sensible*".

Firstly, "*the object of CHAPS is to achieve rapid (maximum of 1.5 hours) payment*". Secondly, "*if the beneficiary's name has to be checked within this period for correspondence with the other identifiers, the evidence is that this would be economically impossible to do*". Thirdly, to require the name of the beneficiary to be checked would impose an unrealistic obligation on the remitting bank, which has no control over how carefully a customer has completed the CHAPS form.

Tomlinson LJ found the third argument persuasive when reluctantly agreeing to dismiss the appeal, noting that "*one can readily conceive of cases in which poor handwriting could inadvertently be misleading as to the identity of the intended beneficiary,*" and concluding that "*grave difficulties [could] arise if payment may only be made where there is correspondence with all four identifiers. Sort code and account number are alone sufficient*

to identify the intended destination of the payment and conformity therewith requires only mechanical checking without the need for the exercise of any subjective judgment".

Floyd LJ disagreed strongly, finding that "*it is clear that the Bank only had authority to debit Tidal's account if a payment was made which complied with the four identifiers on the transfer form*".

Reducing the two reasons to speed and cost, the decision, although controversial, is reasonable when one considers that most CHAPS transfers (which cost £20-£30 each) are business-to-business. One does wonder, however, whether the Court of Appeal might have decided this case differently had a consumer been the victim of the fraud.

Sam Keeling-Roberts

Equitable Compensation

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

After confronting contentious questions of trust law in *FHR v Cedar Capital* [2014] UKSC 45 and *Williams v Central Bank of Nigeria* [2014] UKSC 10, the Supreme Court faced yet another thorny issue involving trusts in the recent case of *AIB Group v Mark Redler & Co.,* namely, what are the principles underlying equitable compensation for breach of trust and how are they to apply in practice?

The facts of the case were as follows. In June 2006, Mr and Mrs Sondhi decided to re-mortgage their property to the sum of £3.3m. The appellant bank (the "Bank") agreed to provide the loan and it instructed the respondent solicitors (the "Solicitors") to act on its behalf. On 1 August 2006, the Bank transferred funds to the Solicitors under strict instructions not to release any money to the homeowners until their existing mortgage with Barclays had been redeemed. Regrettably, the Solicitors made a mistake and the funds were paid out before the existing mortgage was redeemed in full. This meant that the Bank was forced to accept a second charge on the property rather than the first charge it had tried to secure.

The homeowners subsequently defaulted and the property was repossessed and sold for £1.2m. After Barclays had received the outstanding balance on the existing mortgage, the Bank recovered around £850,000 – significantly less than it had lent and substantially less than the amount it would have recovered had it secured a first charge [2-7].

The question for the Court was how much the Bank was entitled to recover from the Solicitors. The Solicitors argued that the correct figure was £275,000 – the difference between the amount that the Bank would have recovered if it had secured a first charge, and the amount that the Bank ultimately received as second chargee. The Bank, on the other hand, claimed £2.5m – the loan less the amount it had recovered when the property was sold [8].

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The Bank came to its figure of £2.5m by submitting that the Solicitors had received the funds on trust and had transferred them to the homeowners without the authority to do so (because the existing mortgage had not been redeemed) [48]. It further submitted that, as the Solicitors had dissipated the trust fund in breach of trust, they should be made to reinstate it. After taking into account the money the Bank had received when the property was sold, the amount required to top the fund back up to its original £3.3m was £2.5m [39].

The Bank's difficulty was that its argument ran contrary to the House of Lords' decision in *Target Holdings v Redferns* [1996] AC 421. However, that case has been the subject of considerable academic criticism [20], with some calling for it to be recognised as a *"false step"* [50] and others condemning it for *"treat*[ing] *equitable compensation in too broad-brush a fashion, muddling claims for restitutive compensation with claims for reparative compensation"* [56]. Consequently, the Bank was sufficiently confident to request a *"reinterpretation"* of the case, or – as Lord Toulson regarded it – to make a *"dressed up attack on it."* [20].

After considering over 900 pages of academic writing [47] and analysing judicial decisions from around the globe (including Canada, Australia, New Zealand and Hong Kong) [121 - 133], the Supreme Court rejected the Bank's argument and upheld the reasoning in *Target Holdings v Redferns*. Lord Toulson and Lord Reed both delivered judgments, with which Lord Neuberger, Lady Hale and Lord Wilson agreed.

Lord Toulson regarded the Bank's argument as an attempt to *"hold* [the Solicitors] *responsible for loss which* [the Bank] *would have suffered on the judge's findings if* [the Solicitors] *had done what they were instructed to do*". Absent fraud (which he accepted might give rise to other public policy considerations), this would be an *"artificial and unrealistic"* assessment of loss that would constitute a penalty [61-65].

Lord Reed's reasoning was substantially the same as Lord Toulson's [78]. However, his judgment is noteworthy for providing the following guidance and clarification on equitable compensation in general:

1. If the trust is still in existence, the correct remedy is to restore the trust fund to the position it would have been in had the trustee performed his obligations appropriately [134].

2. If the trust has ended (or if it is a bare trust) the correct remedy is to pay compensation directly to the beneficiary [106, 134].

3. The amount to be paid does not depend upon whether the trustee is reinstating the trust fund or directly compensating the beneficiary. This is because paying compensation directly to the beneficiary is equivalent to reinstating the trust fund and then distributing it [106, 108, 134].

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4. The measure of compensation depends upon the terms of the trust in question, the nature of the obligation breached and the precise relationship between the parties. For example, where a trust is part of the machinery for the performance of a contract, that fact will be relevant when considering loss [102, 137]

5. Consequently, assessing compensation for breach of trust is generally different from assessing compensation for breach of contract or in tort. This is because a trust imposes different obligations and creates a different type of relationship: in negligence and contract, the parties are taken to be independent and equal actors, concerned primarily with their own self-interest; a trustee, on the other hand, has pledged himself (or herself) to act in the best interests of the beneficiary [83, 136 - 137]. Nevertheless, where the same underlying principles apply to both common law and equitable compensation, the rules should be consistent [138].

6. The amount of compensation should normally be assessed at the date of trial with the benefit of hindsight [110, 135].

7. Forseeability is generally irrelevant. However, the loss must be caused by the breach in the sense that it must *"flow directly from it"* [135].

8. In some circumstances, a third party's act might break the chain of causation [135].

9. Losses caused by the beneficiary's unreasonable behaviour do not flow directly from the breach of trust [135].

The Supreme Court might have frustrated the hopes of the academic community in unambiguously endorsing the House of Lords' approach to equitable compensation in *Target Holdings v Redferns* but, in clearly defining the principles behind the doctrine, it has provided useful guidance that should benefit Judges and practitioners alike. Nevertheless, in finding that the correct approach depends upon the terms of the trust in question, the nature of the obligation breached and the relationship between the parties, the Court appears to have created a flexible test with the scope to adapt to different situations and the potential to develop in a nuanced fashion. If that is the case, this decision might not be the last word on equitable compensation – it might just be the beginning.

Arron Walthall

Articles in this edition have been provided by Richard Oughton, Sam Keeling-Roberts, Arron Walthall and Gary Lewis