"Other People's Money: Accounts, Trusts and Compensation after *Redler*"?[1]

My contribution is provoked by an English Supreme Court decision last year, *AIB Group (UK) plc v Mark Redler & Co.* [2014] UKSC 58 [2014] 3 W.L.R. 1367. In the middle of the afternoon Lord Neuberger grinned as only he can, and said "There is one thing which is certain about our decision". Everyone's already intense concentration redoubled to hear what was coming next. "Whatever it is," he said, "it will be severely criticised!"

Given that there had been strong academic criticisms of the Court of Appeal decision, one of them going so far as to say that its reasoning had been "incoherent", and that the Supreme Court upheld the decision, it seemed likely that he would be right.[2] Although I appeared for the unsuccessful appellant, in practice I expect most commentators to criticise the reasoning rather than the result, because the result reflects sensible risk allocation.

[1]By Nicholas Davidson Q.C.

[2]A notable feature of the case was that the panel in the Supreme Court did not include anyone whose career was in Chancery, and Lord Neuberger was the only member of it who had been a Judge of the Chancery Division.

The battle at the intersection of equity and common law has always been fierce. When Lord Diplock said, in a famous passage, that “the waters of the confluent streams of law and equity have surely mingled now”[3] he was rebuked by In Meagher, Gummow and Lehane’s *Equity: Doctrines and Remedies*,[4] for a statement which was said, by authors who have gone on to be admired Judges, to be “the low water-mark of modern English jurisprudence”.

Lord Toulson began his judgment in Redler with the remark that “140 years after the Judicature Act 1873, the stitching together of equity and the common law continues to cause problems at the seams.” It certainly does.

I shall outline the facts, rounding the numbers for convenience.

Since the 1990s property crash litigation large numbers of lenders and solicitors have become used to conducting the business between them on terms of business which are based on a standard form devised between a lenders’ trade body (the Council of Mortgage Lenders) and representatives of the

---

[3]*United Scientific Holdings Ltd v. Burnley Borough Council* [1978] A.C. 904 at pp.924F-925C.

[4]Lexis, now in its 4th edition – the clash with Lord Diplock appeared in the preface to the second edition.

solicitors and licensed conveyancing professions. It is standard form that the lender's solicitors receive the loan money into their client account where they hold it on trust for the lender, with authority to part with it to the borrower's order in defined circumstances. The circumstances will be "completion" of the conveyancing transaction, invariably including the provision of the security for which the lender has stipulated.[5] Unless that security is provided, the solicitor should not part with the lender's money. All this, including the agreement on the trust status, is a matter of agreement between lender and solicitor.

If the solicitor parts with the money without authority, rules made under statutory power are strict:

"Any breach of the rules must be remedied promptly upon discovery. This includes the replacement of any money improperly withheld or withdrawn from a client account."

And the Court of Appeal has said that the trust can only be discharged either by returning the money to the lender or by obtaining the specified security in exchange for the money.[6]

AIB is a bank with its origins in Ireland. Dr and Mrs Sondhi had two loans from Barclays Bank, secured by a single first legal

[5]"You must hold the money on trust for us until completion. If completion is delayed, you must return it to us when and how we tell you."

[6]*Nationwide Building Society v Davisons* [2012] EWCA Civ 1626 at paragraph 40; *Lloyds TSB Bank plc v. Markandan & Uddin* [2012] EWCA Civ 65 at paragraph 50.

charge on a property, and wanted to refinance.

The first Barclays loan was £1.2 million, the second was £0.3 million.

AIB agreed to lend the borrowers £3.3 million on the basis that Barclays would be paid off and AIB would get a first legal charge. They engaged Redler as their solicitors on the terms I have mentioned. So Redler received £3.3 million on trust for AIB with authority to release it in exchange for a first legal charge of the property. As Barclays needed £1.5 million to discharge their lending, Redler should have paid Barclays £1.5 million, thereby obtaining the release of Barclays charge and released £1.8 million to the borrowers, all in exchange for the first legal charge documentation. Redler didn't handle the matter correctly and wrongly believed they only needed to pay Barclays £1.2 million. They paid Barclays £1.2 million and the Sondhis £2.1 million, and did not get a first legal charge. AIB's money went, and AIB had security ranking behind Barclays, not the first legal charge for which they had stipulated.

Redler were not dishonest. They accepted they had been careless.

Redler could have paid off Barclays, and if they and their insurers had woken up to the point and acted wisely they would have done. If they had done so they would have brought about the same situation that Redferns brought about in the House of Lords case of *Target Holdings Ltd v. Redferns*, of a transaction fully completed albeit by the wrong route. The House of Lords had held that in that situation the lender had no further remedy, the solicitors having effectively remedied the breach.

Mr and Mrs Sondhi defaulted. AIB still had no first charge. The security was insufficient. Barclays were entitled to the first tranche of the proceeds.

AIB, relied on a critical sentence from the *Target* case[7], in the speech of Lord Browne-Wilkinson (with whom everyone else had agreed). Relying on that sentence, AIB argued that the solicitors were obliged to pay to client account for AIB's benefit the whole of the money paid out. It was argued that they would then have been entitled to direct payment of that money out of client account and back to the bank, giving credit, though, for the amount which had actually been recovered under the defective security.

We could be hopeful. There was a good deal of academic commentary, mostly very supportive of our arguments. We had

[7] *Target Holdings Ltd v. Redferns* [1996] A.C. 421.

a line of argument based on the obligation to account, recently analysed in the important Hong Kong case of *Libertarian Investments Ltd v Hall*[8], which will be discussed elsewhere at this conference. We had what we thought was the support of the strong Australian High Court decision in *Youyang Pty. Ltd v Minter Ellison Morris Fletcher*[9] and another powerful Australian decision in *Agricultural Land Management Ltd v. Jackson (no. 2)*[10]*.* And one of my roles was to add the argument that the equitable case simply mirrored the provisions of the Solicitors Accounts Rules, mentioned above, and that the statutory obligation to replace the money in client account should be enforced.

Redler said they were only liable for the £0.3 million. That, looking back, was what AIB had lost: in the *commercial transaction* AIB had lost millions because they had made an unwise loan to the Sondhis; what they had lost *as a result of Redler's breach of duty*, whether breach of trust or breach of contract, was the amount to which Barclays were entitled in priority to AIB.

Redler won. The distinction I have just made is exactly what

---

[8][2013] HKFCA 93.

[9][2003] HCA 15 212 C.L.R. 484.

[10][2014] WASC 102.

appealed to Lord Toulson: see paragraph 58 of his judgment.

But the legal analysis was highly controversial between the Judges, and controversy remains.

There remains dispute as to what was the breach of trust.

The trial Judge's view was that Redler had been in breach of trust as to the extent of £300,000 only. That view was rejected by the Court of Appeal.[11] They held that the whole of the payment away from client account was in breach of trust, but that the remedy still remained at the £300,000 level. I respectfully agree with that identification of the breach of trust. The solicitors had no authority to part with a single pound of AIB's money unless they got a first legal charge over the security property. They didn't get it, so they had no authority to part with any money, and were in breach of trust as regards every pound paid out.

Redler's legal team agreed with that. They did not attempt to challenge that in the Supreme Court.

There are two judgments in the Supreme Court. They are by

[11] [2013] EWCA Civ 45 [2013] P.N.L.R. 325.

Lords Toulson and Reed. Lord Neuberger, Lady Hale and Lord Wilson agreed with both.

Tucked away in paragraph 140 of the judgment of Lord Reed, is the opinion that the Judge was right and the Court of Appeal wrong about what the breach of trust was, though this point was not argued in the Supreme Court.

It is not a happy state of affairs that all future trial Judges remain bound to apply the Court of Appeal's view which the Supreme Court has said is wrong. That may set the scene for another Supreme Court case in this area.

A second controversy is illustrated by a difference of opinion as to what AIB were trying to do. Tremendous contributions to this area of law have been made in extra-judicial writings by Lord Millett, on which AIB's submissions drew heavily. He has said, in an unpublished talk, that he considers the result in *Redler* correct, but that he regretted that we did not attack the reasoning in *Target*. It is true that we did not explicitly do so, and I was clear that our submissions were put on the basis that we did not challenge the reasoning in *Target*. Yet I learn from Lord Toulson's judgment[12] that we were seeking a re-interpretation of the reasoning in *Target* which was in truth a

[12]Paragraph 20.

dressed-up attack on it.

Anyway, the Supreme Court proceeded on the basis that the whole of the payments out were in breach of trust, and we now have the ruling of the Supreme Court on the significance of the following words from the House of Lords decision in *Target*:

> "I have no doubt that, until the underlying commercial transaction has been *completed*, the solicitor can be required to restore to client account moneys wrongly paid away." (My emphasis)

These were the words on which we fastened. We argued that (1) the underlying commercial transaction had not been completed and therefore (2) the solicitor could and should be required to restore the money to client account. I respectfully disagree that our argument was some kind of dressed-up attack on the reasoning in Target. We saw it as a literal application of what the House of Lords had said unanimously. The criticism I might have expected was that we were being literalists.

But we were wrong.

Lord Toulson has told us[13] that:

> “The solicitors did not “complete” the transaction in compliance with the requirements of the CML Handbook.
>
> “But as a commercial matter the transaction was executed or “completed” when the loan moneys were released to the borrowers. At that moment the relationship between the borrowers and the bank became one of contractual borrower and lender, and that was a fait accompli”.

I cannot resist remarking that the same paragraph tells us that the transaction was *not* completed and that it *was* completed. It was not “completed” in the way that that word was used by agreement in the contract between the solicitors and their lender client. It was “completed” in the way that the word was used by the Justices of the Supreme Court.

That is a point that I respectfully regard as of some difficulty. The parties set up the trust arrangement by express agreement, and chose to define the circumstance in which the money could be released by a well-known word with a well-established technical meaning – we cited three cases, one

[13]Paragraph 74.

House of Lords case reported in 1908[14], another a Privy Council case reported in 1984[15] - the well-known Hong Kong completion case, the third a Court of Appeal case from 2005[16]. Yet the Supreme Court were prepared to regard the matter as completed in a different sense, and to proceed from the fact of completion in that different sense.

And one is entitled to ask what does it matter that the establishment of the lender/borrower creditor/debtor relationship was a fait accompli? When a trustee wrongly uses funds to make an unauthorised investment he can be called to account, in the formal sense. The beneficiaries can, if they so choose, adopt the investment, but they are not obliged to do so. When the account is presented, the payment out for the investment can be, in the antique word, falsified. It will be falsified unless the beneficiaries choose to adopt the investment. If it is falsified, then the trustee is treated as having laid out his own money on the investment, and he has to replace the money wrongly paid out. He retains the investment for his own account and makes of it what he can. The investment is a fait accompli, but that does not relieve the

[14] *Lord Advocate v Caledonian Railway Co.* [1908] S.C. 566 (H.L.) at pp. 575, 6.

[15] *Edward Wong Finance Co. Ltd v. Johnson Stokes & Master* [1984] 1 A.C. 296 (P.C.) at pp.303-4.

[16] *Redwell Investments Ltd v. 1-3 Cuba Street Ltd* [2005] EWCA Civ 1799 at paragraph 34 .

errant trustee of the obligation to repay the money that he should not have paid out.

From my standpoint, these cases are indeed about remedy. I hope that Lord Millett will publish his latest thoughts, which he outlined in his talk, at the end of January, to the Professional Negligence Bar Association in London. The English Supreme Court was not receptive to the argument which we put which was based on the trustee's obligation to account. Lord Millett, though agreeing with the result in *Redler*, maintained that the taking of an account should be an important step in the analysis of cases of misapplication of trust funds, and it would be good to see in hard copy his analysis of the particular case, which clearly differs from that which we put before the Supreme Court which I fear was dismissed with reference to fairy tales, rather than with any reasoned exposition of the error in our analysis.

But taking of account or no, one is left with the question of substantive remedy, for what the claimant wants is an order that money be paid in a particular way. My current thinking is that *Target* and *Redler* guide English courts to identify the point at which the beneficiary ceases to be entitled to have the money trust fund restored to its original amount. At that point the remedy switches from reconstitution of the trust fund to the provision of equitable compensation. While that may be more extensive than the common law notion of damages, because the restrictions are less than those in place at common law (foreseeability is not a concern, and the approach to avoidable loss is gentler[17]), we know it to be compensation for the commercial loss which, with hindsight, can be seen to have been sustained, and the Court will, in making the assessment, consider what the commercial result would have been if the defendant had not erred. This critical point is made in the speech of Lord Reed at paragraph 134.

I still find *Redler* a fascinating case. I am unabashed in taking the view that the Court of Appeal were right to say that all the money was paid in breach of trust, and that the Supreme Court obiter dictum the other way is unfortunate. I am unconvinced by the fait accompli point. But then, the whole setting of the case was strange. Not only was this a preliminary issue which went the full height of the appeal system but, factually, things might have been handled differently when the defect in the security first came to the bank's attention. It is worth thinking of three possible factual scenarios, any of which may arise for another day.

---

[17] *Canson Enterprises Ltd v Boughton & Co.* (1991) 85 D.L.R. (4th) 129 at 162-3 per McLachlin J., followed by Blackburne J. in *Nationwide Building Society v. Balmer Radmore* [1999] Lloyd's Rep. P.N. 241 at 282: not "required to mitigate, as the term is used in law" but "losses resulting from clearly unreasonable behaviour … will be adjudged to flow from that behaviour and not from the breach."

First, on discovery of the problem the solicitors and their insurers might have bought Barclays off: as a card player might say, they could have paid up at the score. My view is that this should not be done behind the lender's back but, at least in the absence of dishonesty by the solicitor, the solicitor is then safe on the *Target* basis.

I actually consider that the right course is for the solicitor to replace what has wrongly gone from client account and seek fresh instructions from the client. I suspect that this is a minority opinion, but it is consistent both with the Accounts Rules, which have statutory force, and with the terms of the trust under these conditions, which require reference back to the lender if completion is delayed.

One of two things would then have followed.

One would have been for AIB to say: "If you pay off Barclays and get the first legal charge, that will be fine by us".

The other would have been for AIB to say: "Please give us the money back. You and your insurers can take the security, such as it is, and all our rights against the Sondhis."

In the former case – getting Barclays paid off – the position would have been regularised and AIB would have had no residual claim against Redler. The Judge was clear that that is what would have happened. It is what should have happened. But it didn't.

I sense a certain reluctance to accept that the bank should have had the option to say "We want our money back" and walk away from the fait accompli of the loan.

The factual history was messy, because the problem was not handled to advantage by anyone before the default occurred. It led to litigation of great interest and great dispute. One of our opponents in the Supreme Court has described the result as a good one for modern trust law. While I can see the merits of equitable compensation as a flexible remedy, I don't see the case as a good one for modern trust law.

- - -