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

A few years ago there was a really good tv advertisement for The Guardian which depended on showing the same scene taken from three or four different cameras. It’s good to look at problems from different angles, and I want to look at the outcome of two cases not from the usual viewpoint of a legal analyst but from the viewpoint of the insurer and adviser faced with a new claim or circumstance. The first of the cases was decided almost exactly 20 years ago, on 20 July 1995; the second last year. I was involved in the second, though only in the final few weeks for the Supreme Court hearing. We lost. Many a student will have been facing a question on these cases in this summer’s exams, but I think the interest from an insurer’s point of view is how future claims may be framed and what is a sensible response. If the law is developing as it should, it should be possible for parties to tackle such claims more economically in the future.

Looking after other people’s money has been giving rise to a lot of trouble. In theory safe keeping should not be too difficult, but we know that problems turn up in practice. In April a highly respected bank’s custodianship operation was fined no less than £126 million by the FCA for breaches of the FCA Client Assets Sourcebook (Custody Rules, or CASS). Two notable features are that £126 million was a discounted fine, representing a 30% discount from what would otherwise have been

¹By Nicholas Davidson Q.C.
£180 million, on account of early settlement of the allegation of breach, and that this was *not* a case in which any loss had resulted from the breaches. The episode just reminds us how problematic even the mechanical side of looking after other people’s money is, never mind the investment side.

Insurers of professionals handling others’ money will usually, of course, be on risk. This has cropped up frequently in the case of solicitors and conveyancing. I believe that the principles are the same in all commercial cases where professionals are handling money which is subject to obligations of trust. There are other similar situations. 25 or so years ago I handled a case where it might have been in question whether monies were trust monies or not, but what was definitely in question was what trades by a commodity broker had actually been authorised by the client, who had been speculating in cocoa and other commodities on the London and New York markets, ringing in daily, literally from Bondi beach, to place trades; the broker had tried to book to the client more trades than the Judge held he had actually authorised. The resulting question was what the true state of account between the parties ought to be.

But let’s look at things from an insurer’s perspective, which means that one starts by thinking about the policy.

I am not sure how widely appreciated it is that there is an important definition which makes its way into the Minimum Terms for solicitors’ insurance. Those incorporate definitions from the Glossary to the SRA Handbook. When you turn that up you will find this (emphasis mine):
claim means a demand for, or an assertion of a right to, civil compensation or civil damages or an intimation of an intention to seek such compensation or damages. For these purposes, an obligation on an insured firm and/or any insured to remedy a breach of the Solicitors’ Accounts Rules 1998 (as amended from time to time), or any rules (including, without limitation, the SRA Accounts Rules) which replace the Solicitors’ Accounts Rules 1998 in whole or in part, shall be treated as a claim, and the obligation to remedy such breach shall be treated as a civil liability for the purposes of clause 1 of the MTC, whether or not any person makes a demand for, or an assertion of a right to, civil compensation or civil damages or an intimation of an intention to seek such compensation or damages as a result of such breach, except where any such obligation may arise as a result of the insolvency of a bank (as defined in section 87 of the SA) or a building society which holds client money in a client account of the insured firm or the failure of such bank or building society generally to repay monies on demand.

Without that definition one would expect a claim to involve some third party making a claim against the insured. So it often will, but we have here an extended definition which means that in some circumstances what counts, as between insurer and insured, as a claim, will not have involved any communication between the insured and any third party who may in practice be entitled to a remedy against the insured.

If you look at any version of the accounts rules, you will find a strict obligation on solicitors: the obligation is created under statutory powers, and if the solicitor parts with the money without authority, there is this rule:

“There 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.”

So we have this situation:

- If money is improperly withheld or withdrawn from a client account
there is a breach of the rules;

- Upon discovery of that breach – and that means upon discovery by anyone, including especially the solicitors’ practice, of the breach – the insured comes under an immediate obligation to remedy the breach, including replacing the money in question;

- Upon discovery of the breach the definition I have mentioned has the effect that there is a claim for the purposes of the policy.

In practice this means that on discovery of the breach the insurer will in almost every case come under an immediate obligation to provide the funds sufficient to enable the shortfall on client account to be made good.

So what ought to happen is that the shortfall in client account ought to be made good.

There then arises the question what the solicitor ought to do with the money restored to client account. That will depend on the terms of the instructions between him and the client. In many cases reference to those terms will show that what the solicitor ought to do is to contact the client and seek fresh instructions as to what to do with the money.

In practice things don’t always work out like that. My suspicion is that this is quite often because some solicitors are neglectful of their precise obligations under the Accounts Rules; some don’t think back to identification of their instructions; and few think about the insurance position which I have described. The two leading cases are cases in
which the solicitors did not hasten to tell their clients what had happened, nor did they perform their obligation under the Accounts Rules.

They are also both cases in which the lending turned sour, in that the borrowers defaulted and the security was realised for far less than was necessary to clear the debt, largely because the property market had suffered a downturn before the security was enforced. The lenders tried to use traditional trust law to their advantage, claiming that they should have their money back because the solicitors had, they said, acted without authority. But the Courts arrived at the result that the lenders should only receive compensation to the extent that they were worse off than they would have been if the transaction had been carried through successfully in the way in which it should have been.

The case last year in the Supreme Court was *AIB Group (UK) plc v Mark Redler & Co.* [2014] UKSC 58 [2014] 3 W.L.R. 1367. We had a hearing compressed into a single short day. 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. But there is little published criticism yet, although there has been quite a lot of noise from academics suggesting that criticism will be published. There is at least one good article, and there was a recent symposium about the case here in Oxford. I expect most commentators to think that the result reflects sensible risk allocation, but getting to that result needed quite a lot of ingenuity.

I think it might have been simpler if we had all thought of the matter in terms of an account.

The taking of an account in the Courts sounds quite ghastly, and certainly brings to mind the pictures conjured by Dickens. One may shudder at it for a number of reasons.

One reason is that as a matter of procedure it is very obscure: there is no specific rule explaining it all in one place, and one has to hunt round from rule to rule and from Practice Direction to Practice Direction.

Another is that the language is archaic. Lawyers, of course, should be happy with definitions, which can bring precision. But talk of an account being falsified, or of someone who is liable to account being surcharged would lead to puzzled eyebrows even if one had not been to a banquet the night before.

The concept is actually quite simple. One party entrusts money to

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2A 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.
another on terms that it is only to be used in ways which have been authorised. At any later time he is entitled to ask:

- What has become of my money?

- Tell me what you have done with it?

And in litigation this is done by claiming an account. If the defendant is obliged to answer the questions, then he should provide a statement of account. In modern terms this is conveniently done on a computerised spreadsheet.

A main battleground has been that defendants add an extra question: What, they ask, would you have done if I had behaved as you think I should have? Whether the answer to this question matters has been a matter of importance for 25 years. It usually does matter, the main exception being cases of fraud.

When an account is to be taken, the defendant says what has happened.

The next question is whether that is the same as what should have happened. If it is, well and good; if not, the Court wants to find out what the position ought to be.

If the claimant challenges any given payment out, the defendant has to show that it was authorised. If it was not, then the Court adjusts the account accordingly. If a payment out is disallowed, it is said to be falsified.
If the claimant says that something else should have been credited, and the Court agrees, then the Court adjusts the account accordingly. It is said that the defendant has been surcharged.

The basic concept is to look at what the account ought realistically to be, and to order the defendant to make good any shortfall.

Lawyers can make things complex. The aim of the lenders in such cases has been to persuade the Court that there ought to be a balance due to the lender once the account has been taken: to persuade the Court that every payment out made by the solicitors should be disallowed, producing a picture which shows that there should be full repayment to the claimant of the money originally paid over to the solicitors, subject only to credit for anything which has actually been recovered after the default.

Lord Toulson began his judgment in Redler with the remarks about law and equity. In particular he said that “140 years after the Judicature Act 1873, the stitching together of equity and the common law continues to cause problems at the seams.” That is lawyer language directed to lawyers. All lawyers would agree with his remark that there are problems at the seams.

I shall outline the facts of *Redler*, 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 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.³ Note that word “completion”. Nothing less will do. 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.

I repeat that if the solicitor parts with the money without authority, the rule is 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.”

The next thing to have in mind is that 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.⁴ That means that unless either of those things happen the solicitor stays subject to the trust obligation. This is just like the obligation under the rules. If the solicitor can’t show that he has obtained the specified security then he must be ready to pay the money back to his client. He

³“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.”

⁴Nationwide Building Society v Davisons [2012] EWCA Civ 1626 at paragraph 40; Lloyds
may be able to be excused from this under the discretion which the Court sometimes has under the Trustee Act 1925, if the solicitor has acted honestly and reasonably.

AIB is a bank with its origins in Ireland. They were approached by a Dr and Mrs Sondhi. That couple had two loans from Barclays Bank, secured by a single first legal 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 might have done. I have
said what I think they and their insurers should have done, which is, to
put the necessary sum into client account, report to their client and act in
accordance with the client’s new instructions.

It could be argued (but I think it would be wrong) that it would be equally
correct if they simply paid off Barclays without referring to the client.
One can see that happening if people were generally aware that the
situation ought to be regularised but didn’t focus precisely on the
obligation under the Rules, or considered (and they do have support
from the Supreme Court) that it would remedy the breach under the
Rules if they did something other than pay into client account with the
result that the necessary security was obtained.

If they had done that 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. I shall come back to Target.

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\(^5\), 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 a line of argument based on the obligation to account, recently analysed in the important Hong Kong case of *Libertarian Investments Ltd v Hall*\(^6\), which anyone concerned with a claim for an account should refer to. We had what we thought was the support of the strong Australian High Court decision in *Youyang Pty. Ltd v Minter Ellison Morris Fletcher*\(^7\) and another powerful Australian decision in *Agricultural Land Management Ltd v. Jackson (no. 2)*\(^8\). 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

\(^{5}\) *Target Holdings Ltd v. Redferns* [1996] A.C. 421.

\(^{6}\) [2013] HKFCA 93.

\(^{7}\) [2003] HCA 15 212 C.L.R. 484.

\(^{8}\) [2014] WASC 102.
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. If Redler had acted correctly all would have been well; if Redler had reported what had happened promptly AIB would have said “you pay off Barclays and get us the overpayment back from the Sondhis”; or Redler and their insurers could simply have paid off Barclays and obtained the required security.

Redler won. The distinction I have just made about the commercial transaction is exactly what appealed to Lord Toulson: see paragraph 58 of his judgment.

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

There even remains dispute as to what was the breach of trust. This may give rise to another Supreme Court case in due course.

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. 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. In their position I would not have argued the point even at trial; in any event, having lost on it in the Court of Appeal I, too, would not have tried to resurrect the point in the Supreme Court.

There are two judgments in the Supreme Court. They are by 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 former Law Lord 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 am
told by Lord Toulson’s judgment\(^{10}\) that we were seeking a re-
interpretation of the reasoning in *Target* which was, he said, in truth a
dressed-up attack on it.

What had happened in *Target* was that the solicitors had produced the
intended result but with serious delay. An improper first payment did not
obtain the required charge. But later they got the charge. And that led
to the conclusion that the lender was not entitled to repayment of the
sums which had been paid without authority at the time they were made.

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.

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\(^{10}\)Paragraph 20.
But we were wrong.

Lord Toulson has told us\(^\text{11}\) 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 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 House of Lords case reported in 1908\(^\text{12}\), another a Privy Council

\(^{11}\)Paragraph 74.

\(^{12}\)Lord Advocate v Caledonian Railway Co. [1908] S.C. 566 (H.L.) at pp. 575, 6.
case reported in 1984\textsuperscript{13} - the well-known Hong Kong completion case, the third a Court of Appeal case from 2005\textsuperscript{14}. 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, investment for his own account and makes of it what he can. The investment is a fait accompli, but that does not relieve the errant trustee of the obligation to repay the money that he should not have paid out.

Where we may have got is the equivalent of this. In the particular case, the money that the solicitor should not have paid out is the extra £300,000 paid out to the Sondhis. So the solicitor should repay that sum is the practical result. I have difficulty accepting the argument that to do so would remedy the breach of the Accounts Rules, but the Supreme Court reckons that paying off Barclays, or the equivalent sum, would do so.


\textsuperscript{14}Redwell Investments Ltd v. 1-3 Cuba Street Ltd [2005] EWCA Civ 1799 at paragraph 34.
From my standpoint, these cases are indeed about remedy. I hope that Lord Millett will publish his latest thoughts. 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.

The first thing is I think it helps to look at the account and see what has happened. Then one can see what action now by the insured professional can produce a result equivalent to that which should have been produced. I think the Court is helped by looking to see what the end result of the account should look like.

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\textsuperscript{15}, 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 \textit{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.

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 \textit{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

\textsuperscript{15}\textit{Canson Enterprises Ltd v Boughton & Co.} (1991) 85 D.L.R. (4\textsuperscript{th}) 129 at 162-3 per McLachlin J., followed by Blackburne J. in \textit{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
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. What I
behaviour and not from the breach.”
do think is that people should ask for an account, and that it should help everyone resolve these problems more quickly and more cheaply if people focus on what the outcome should have been, and what can be done to make good any difference between that and what actually happened.