



Illegality as a Defence to Negligence Claims against Solicitors: *Stoffel & Co v Grondona* [2020] UKSC 42

Introduction

The Supreme Court has recently handed down its judgment in *Stoffel & Co v Grondona* [2020] UKSC 42 in which it dealt with the applicability of an illegality defence to a negligence claim against a firm of solicitors where the Claimant had perpetrated a mortgage fraud.

We have therefore set out a short update on the decision.

Illegality – The *Patel v Mirza* Guidelines

An illegality defence is essentially one where a court refuses to accede to a Claimant's claim because of some "illegal" conduct on the part of the Claimant. It is based on Latin maxims such as "*ex turpi causa non ortur actio*" which translates to "*no action arises from a disgraceful cause*".

Prior to the decision of the Supreme Court in *Patel v Mirza* [2016] UKSC 42, there had been significant uncertainty as to the approach to be taken to the defence of illegality to claims. In *Patel v Mirza* the majority of the Supreme Court rejected the principle that relief was refused to parties who had to rely on their own illegal conduct to establish their case. The Supreme Court decided that in determining whether an illegality defence should prevent a Claimant from recovering losses, a court was to adopt a flexible approach by considering what Lord Toulson said were a "*trio of necessary considerations*" in relation to the alleged illegal conduct. He stated these were:

"...(a) considering the underlying purpose of the prohibition which has been transgressed, (b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality...."

The Facts

On 1 March 2002, Ms Grondona entered into an agreement with Mr Mitchell in relation to four properties whereby:

- a. Mrs Grondona obtained mortgage loans in her names.
- b. Mr Mitchell was to make all payments in respect of the mortgage loans.
- c. Mr Mitchell was to receive from the tenants all of the rents due.
- d. Mr Mitchell was to carry out all repairs to the properties as and when required.
- e. Mr Mitchell was to deal with all financial matters concerning the properties.
- f. Mr Mitchell was to decide when to sell the properties.
- g. In the event of a property being sold, Mr Mitchell was to pay 50% of the net profits to Mrs Grondona.

This was essentially a business relationship whereby Mrs Grondona obtained finance for Mr Mitchell with a view to making a profit seemingly because Mr Mitchell was often unable to raise finance himself from high street lenders.

In around July 2002, Mr Mitchell acquired a 125-year lease of 73b Beulah Road ("the Property") for the sum of £30,000. The lease of the Property was purchased with a loan from BM Samuels and a charge was registered against the title to the Property at the Land Registry – it also secured further advances that would be made to Mr Mitchell.

In October 2002, Mrs Grondona "*purchased*" the Property from Mr Mitchell for £90,000. This was three times the sum Mr Mitchell had paid only a few months earlier. She did so with the assistance of a mortgage loan from Birmingham Midshires in the sum of £76,475. That loan was to be secured by charge over the Property.

In fact, the mortgage loan was procured by Mrs Grondona by fraud. She had dishonestly misrepresented to Birmingham Midshires that the sale from Mr Mitchell was not a private sale, the deposit was from her own resources and that she was managing the Property. The purpose of the fraud was to obtain finance for Mr Mitchell from a high street lender which he could not otherwise have obtained.

Mr Mitchell and Mrs Grondona executed a Transfer conveying the Property to Mrs Grondona. The monies advanced by Birmingham Midshires were to be used in part to discharge the charge in favour of BM Samuels. BM Samuels provided a form DS1 being one which confirms that the Property is released from the charge and is provided to the Land Registry to confirm that.

Stoffel & Co were instructed on behalf of Mr Mitchell, Mrs Grondona and Birmingham Midshires. However, by their admitted negligence they failed to register at the Land Registry the Transfer, the form DS1 releasing the BM Samuels Charge and the Birmingham Midshires Charge.

The result of this was that Mr Mitchell remained the registered owner of the Property at the Land Registry and BM Samuels still had a charge over the Property, which secured further advances to Mr Mitchell. Indeed, further advances were made to Mr Mitchell by BM Samuels.

Mrs Grondona defaulted on the loan from Birmingham Midshires. They could not recover the Property as their charge had not been registered. By the time of the trial BM Samuels had recovered the Property pursuant to the charge registered in its favour to recover further advances made to Mr Mitchell - this could not have happened but for Stoffel & Co's negligence. Mrs Grondona claimed an indemnity from Stoffel & Co for the sums due to Birmingham Midshires because had the charge of been registered Birmingham Midshires could have recovered the Property and sold it to realise the monies owed to it by Mrs Grondona pursuant to the mortgage loan.

The Issue

Stoffel & Co accepted that their failure to register the Transfer, the DS1 Form releasing the BM Samuels charge and the Birmingham Midshires charge was negligent. The issue for the Supreme Court to decide was whether the mortgage fraud perpetrated by Mrs Grondona meant that her otherwise entitlement to damages should be dismissed on the grounds of illegality.

The Supreme Court's Decision

The judgment was given by Lord Lloyd-Jones with whom Lord Reed, Lord Hodge, Lady Black and Lady Arden agreed.

Lord Lloyd-Jones referred to the "*trio of necessary considerations*" as regards the establishment of an illegality defence as identified by Lord Toulson in *Patel v Mirza* which, as explained above, were:

1. The underlying purpose of the prohibition which has been transgressed.
2. Conversely any other relevant public policies which may be rendered ineffective or less effective by a denial of the claim.

3. Lastly, keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality.

Lord Lloyd-Jones explained that meant the court was required to identify the *"policies to which the law gives effect"*, which are engaged by the question of whether to allow the claim or not. He explained that the *"essential question"* is *"whether to allow the claim would damage the integrity of the legal system"* and that the answer will *"depend on whether it would be inconsistent with the policies to which the legal system gives effect"*. He then considered the *"trio of necessary considerations"*.

Consideration 1 - Would the underlying purpose of the prohibition that has been transgressed be enhanced by a denial of the claim?

It was accepted that Mrs Grondona's conduct in perpetrating a mortgage fraud would have constituted a criminal offence under the Theft Act 1968. Lord Lloyd-Jones agreed that deterrence of mortgage fraud was an underlying policy of the criminal law. However, he doubted that *"permitting a civil remedy to persons in the position of the respondent would undermine that policy to any significant extent"*.

Furthermore, Lord Lloyd-Jones stated that there was a further prohibition against mortgage fraud which was *"the protection of the public, and in particular mortgagees, from suffering loss"* and stated that viewed *"from this perspective, it is difficult to see how refusing [Mrs Grondona] a civil remedy against her solicitors for their negligence in failing to register the transfer would enhance that protection"*. He observed that the registration of the Transfer and the Birmingham Midshires charge was not a necessary step in perpetrating the fraud and by the time of Stoffel & Co's negligence the fraud had already been perpetrated. Importantly, he observed *"denying a remedy to [Mrs Grondona] in respect of negligence in what occurred subsequently would not afford any protection to Birmingham Midshires"*.

Furthermore, Lord Lloyd-Jones explained that the registration was not only in the interests of Mrs Grondona, but was also in the interests of Birmingham Midshires because they would have had the security it required for the loan advanced.

Consideration 2 - Is there any other relevant public policy on which the denial of the claim may have an impact?

Lord Lloyd-Jones explained that an important countervailing policy in play was that *"conveyancing solicitors should perform their duties to their clients diligently and without negligence"*. He said that to *"permit solicitors to escape liability for negligence in the conduct of their clients' affairs when they discover after the event that a misrepresentation was made to a mortgagee would run entirely counter to these policies"*. Lord Lloyd-Jones was also seemingly influenced by the fact that the transactions bore hallmarks of fraud of which the solicitors were aware. Namely, the purchase price of £90,000 was three times of the purchase price of £30,000 paid by Mr Mitchell three months earlier.

A further countervailing public policy related to property rights. Legally, where a property is transferred for an illegal purpose the transferee (who in this case would be Mrs Grondona) obtains good title in law and equity even though it would not be capable of specific enforcement. In this case, Mrs Grondona acquired equitable title to the Property once the Transfer had been executed. She never obtained legal title to the Property because the Transfer was never registered at the Land Registry. Lord Lloyd-Jones stated that:

"It would, in my view, be incoherent for the law to accept on the one hand that an equitable interest in [the Property] passed to [Mrs Grondona], notwithstanding that the agreement for sale was tainted with illegality, while on the other refusing, on the basis of the same illegality, to permit proceedings against [Stoffel & Co] in respect of their failure to protect that equitable interest by registering the [Transfer] at the Land Registry".

The Result of Considerations 1 & 2

In light of the above considerations, Lord Lloyd-Jones found that the illegality defence of Stoffel & Co had failed for the following reasons:

- a. To permit Mrs Grondona's case "*would not undermine the public policies underlying the criminalisation of mortgage fraud*" but could operate in a way to protect the victims of mortgage fraud who in this case was Birmingham Midshires.
- b. To deny Mrs Grondona's claim would be inconsistent with the policy that victims of solicitors' negligence should be compensated for their loss and it would be a "*disincentive to the diligent performance of their duties*".
- c. Furthermore, to deny Mrs Grondona's claim on the grounds of illegality would result in an "*incoherent contradiction given the law's acknowledgment that an equitable property right vested in [Mrs Grondona]*".

Consideration 3 – Proportionality of the response to illegality

It was not necessary for the court to deal with the third of the trio of relevant considerations being the issue of proportionality of the response to the illegality, but it was dealt with, nonetheless. Essentially, Lord Lloyd-Jones was of the view that dismissing the Claimant's claim on the grounds of illegality would not be proportionate because the "*claim for breach of duty against [Stoffel & Co] is conceptually entirely separate from [Mrs Grondona's] fraud on Birmingham Midshires*". Essentially, the logic was that Mrs Grondona's fraud of obtaining a mortgage advance by dishonesty had already been carried out before Stoffel & Co's negligence of failing to register the Transfer and Birmingham Midshires charge.

Making a Profit from Wrongdoing

It is important to highlight that Lord Lloyd-Jones made clear that this was not a claim by Mrs Grondona to recover a profit or a case of the court "*assisting a wrongdoer to profit from her own wrongdoing*". Rather, Mrs Grondona was seeking damages / an indemnity from Stoffel & Co to put her in the same position she would have been had the Transfer and Birmingham Midshires Charge of been registered i.e. to compensate her for the monies that Birmingham Midshires should have been able to recover from the Property (as opposed to any profit element of the illegal scheme). He stated that:

"Clearly, it would be objectionable for the court to lend its processes to recovery of an award calculated by reference to the profits which would have been obtained had the illegal scheme succeeded".

If this were a case where Mrs Grondona was seeking damages to say compensate her for any profit lost as a consequence of the illegal scheme not coming to fruition that would be a factor to be considered as part of the trio of considerations discussed above. In such a case, we would suggest an illegality defence may have succeeded.

Further Information

Given the generality of the note it should not be treated as specific advice in relation to a particular matter as other considerations may apply.

Therefore, no liability is accepted for reliance on this note.

If specific advice is required, please contact one of the Partners at Caytons who will be happy to help.

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