Various Purchasers v 174 Law v Key Manchester [2022] EWHC 4 (Ch)

Introduction

On 10 January 2022, HHJ Hodge QC (sitting as a Judge of the High Court) handed down judgment in *Various North Point Pall Mall Purchasers v 174 Law Solicitors Limited v Key Manchester Limited* [2022] EWHC 4 (Ch)

This case, in which Caytons acted for the Part 20 Defendant, appears to be the first claim against solicitors arising from buyer-funded developments in the UK to come before the courts for trial. The case was primarily concerned with the role of the seller's solicitor as stakeholder, but the judgment is of general interest to those dealing with claims concerning developments of this sort.

The project

The action arose from the collapse of a property developer named North Point Global, which had been developing a series of newbuild residential and student accommodation projects in the Northwest of England. It marketed its projects off-plan to individual investors in Hong Kong. The particular project under consideration was a large residential development in Liverpool known as North Point, Pall Mall ('Pall Mall'). As with all of that developer's projects, it was funded on what is known as the 'fractional sales model'.

The fractional sales model

This is an alternative funding model which was developed after the Credit Crunch when traditional development finance became scarce for projects outside the M25. It involves investors advancing a significant proportion of the purchase price of a unit in the development on exchange and the monies being applied by the developer to fund the project. The investor will typically pay a discounted price as against the market value of the finished unit and will often, as here, be offered incentives such as a guaranteed rental income for a period after completion and interest at a favourable rate on the sums invested.

The Claimants sought to argue that this arrangement was highly unusual and implied, without saying in so many words, that it was an obvious scam. However, we amassed evidence of 100 residential and student developments which had been funded on the same model and successfully carried to completion and, by the time the matter went to trial, the Judge had no difficulty in finding that *"This development model had gained in popularity after the 'credit crunch' towards the end of the first decade of this century and, by 2015, it was an established, albeit risky, form of property investment".*

The buyers' company

In many fractional sales projects, the monies paid on exchange are held by the seller's solicitor as agent and released to the developer straightaway. In the Pall Mall project, there was what was described in solicitors' correspondence as "*a measure of protection*" for investors in that the monies were held by the seller's solicitor as stakeholder to the order of a so-called buyers' company and only released to the developer when a supervisor - the company which acted as Employer's Agent under the Building Contract - issued interim certificates for build costs and/or when invoices were produced for other costs, including marketing commissions and professional fees.

The buyers' company was a separate limited company whose directors were solicitors from the firm acting for the seller, originally David Roberts & Co and later 174 Law, the Defendant to this action, and the two preferred firms for buyers, Oliver & Co and Key Manchester. Buyers of units in the development were deemed to have agreed to become members of the company upon entering into Agreements for Sale.

The Agreements for Sale provided that the buyers' company was to have a legal charge over the development site. It was a precondition to the release of funds to the developer that the buyers' company had a first legal charge over the site, although there was provision for the charge to be downgraded if the developer sought further funding from a lender.

The charges

In June 2015, the developer took out a bridging loan to buy the site. The lender took a first charge over the site. The developer wanted to retain the possibility of borrowing further monies under the bridging loan facility. To accommodate for this and comply with the terms of the Agreements for Sale, the developer elected to repay the loan from its own resources, allowing the lender's charge to be removed from the title, so that the buyers' company could obtain a first charge. It was intended that the buyers' company would then enter into a deed of priority with the lender, as the Agreements for Sale permitted, to allow for a fresh bridging loan to be advanced and secured against the site with priority over the buyers' company charge.

Through what appears to have been poor communication between solicitors, the lender ended up registering its new charge first. When David Roberts discovered this, he refused to release any further monies and pointed out that he had unwittingly breached an undertaking given to Oliver & Co by releasing an earlier tranche.

The workaround

In October 2015, David Sewell, the solicitor responsible for the matter at Oliver & Co and a director of the buyers' company, proposed a workaround which he believed restored the position to what it would have been if things had been done as intended. This proposal was agreed by all relevant parties, including the lender and the solicitor at Key Manchester who was also a director of the company.

The retainer of 174 Law

The relationship between the developer and David Roberts & Co subsequently broke down and that firm was dis-instructed in favour of 174 Law in November 2015. During the course of the project, the supervisor periodically issued certificates and 174 Law released monies against them.

Divergent views were expressed by the solicitors involved about the procedure for release of monies, but all ultimately came to accept 174 Law's construction of the payment release provisions in the Agreement for Sale, namely that the seller's solicitor was entitled to release monies once certificates were issued and did not need to seek further approval from the other directors of the buyers' company. There was a dispute about when this was agreed.

The failure of the developer

An apparent fraud by another unrelated developer which used the same marketing agent appears to have spooked the Hong Kong market. As one of the developer's representatives put it, sales fell off a cliff in mid-2016. They never recovered. Work continued on site until the end of 2016 but, eventually, the developer ran out of money and its business failed. A receiver appointed by the lender sold the site. The monies invested by individual buyers were lost. It is apparent that, if the buyers' company had secured and retained a first charge, the buyers would each have recovered somewhere around 9p in the Pound.

The fallout

The proceedings were just part of the fallout from the collapse of these two developers and another which appears to have catastrophically underestimated construction costs of its flagship project making it unviable. It was widely alleged that the latter two also involved fraud, although this was based more on inferences rather than actual evidence. The Serious Fraud Office was persuaded to open an investigation.

The Solicitors Regulation Authority revised an existing warning notice to bracket fractional sales projects with other more esoteric transactions which had been found in previous cases to be frauds or unlawful collective investment schemes. It also prosecuted David Roberts for alleged dishonesty on the basis that the projects in which he acted as seller's solicitor were inherently dubious.

The grounds for this allegation were very flimsy and were comprehensively demolished by the Solicitors Disciplinary Tribunal. The prosecution only succeeded on the narrow grounds of breach of undertaking to register the buyers' company charge and conflict of interest in acting as seller's solicitor and director of the buyers' company. This attracted a modest fine.

David Hayhurst of 174 Law and David Sewell of Oliver & Co, both of whom had by then retired from practice, agreed outcomes with the SRA in which they accepted failings when acting as buyers' solicitor in return for small fines and avoiding the likely irrecoverable costs of going to tribunal. Notably, in contrast to the position taken in Roberts, each agreed outcome recorded that "*The SRA does not regard* (fractional sales) *schemes as inherently dubious, but it does regard them as being inherently risky".*

In October 2021, following an investigation lasting almost three years and reportedly involving scrutiny of tens of thousands of documents, the SFO closed its file for want of evidence.

The Claimants nevertheless opened with a suggestion that the developer and at least some of the solicitors were involved in some sort of incestuous conspiracy. However, this was not developed in the trial and would not have been plausible on the witness evidence.

The proceedings

The proceedings began as part of a much larger series of group actions against conveyancing solicitors which were case-managed together and were to be heard in sequential trials. Some 14 Claimant cohorts, totalling around 300 individuals, brought claims against 5 firms arising from the demise of 6 property development projects, including Pall Mall.

The litigation gave rise to a reported interim judgment on the liability of solicitors under the Financial Services and Markets Act 2000: see *Various Claimants v Key Manchester Limited* [2021] PNLR 15.

One of the Claimant cohorts, represented by Penningtons Manches Cooper, brought parallel claims against their own solicitors, Key Manchester, for professional negligence and 174 Law for breach of the stakeholder agreement. The other groups only pursued their own solicitors. All of the claims advanced against buyers' solicitors settled. This left the claim against 174 Law and a contribution claim brought by 174 Law against Key Manchester.

The existing law on stakeholders

This appears to be the first time that the position of stakeholders in a buyer-funded development has been considered by the courts.

In the context of a traditional residential conveyancing transaction, however, their position is well-established. The modern law starts with *Potters v Loppert* [1973] Ch 399 but can be traced back into the nineteenth century. Where the seller's solicitor acts as stakeholder, two contracts come into being, the sale agreement between the buyer and the seller and the implied stakeholder agreement between the buyer, the seller and the seller's solicitor. The role and obligations of the stakeholder are limited. It is to hold the monies ('the stake') until a 'triggering event' happens and then release them to the appropriate party.

Under the Law Society's Standard Conditions for Sale, the triggering events are completion or recission of the contract. Upon completion, or in the event of recission by the seller following the buyer's failing to comply with a notice to complete, the stakeholder is to release the stake to the seller. In the case of recission by the buyer if the seller fails to complete, or the contract being rescinded without either party being in default, the stake is to be returned to the buyer.

Once there has been a triggering event, the stakeholder is entitled and obliged to release the stake. It need not seek further authorisation from the other parties to the stakeholder agreement, sometimes called 'the depositors'. The depositors can direct that the stakeholder apply the monies in a different manner than provided for in the sale agreement but one of them cannot do so unilaterally.

The relationship between the stakeholder and the depositors is purely contractual. The stakeholder does not owe fiduciary duties and the stake does not constitute trust monies.

The trial

The matter came on for trial in the Business and Property Courts in Manchester in November 2021. It was heard over 10 days. The Claimants gave evidence by video-link from Hong Kong. 174 Law called evidence from its own representatives and, under summons, from solicitors from Oliver & Co and Key Manchester and the former Finance Director of the developer.

The arguments

There was a large degree of common ground as to the law relating to stakeholders and it was not seriously disputed that the established principles should have application to a transaction of this nature.

The Claimants argued that they were parties to the stakeholder agreements and entitled to enforce them. Their primary case was that the buyers' company was their agent and not a party to the stakeholder contract in its own right. Their secondary case was that there was a quadripartite agreement with both individual buyers and the buyers' company being parties. They maintained that it was a condition precedent to release of the stake that the buyers' company had a first legal charge over the site. The company never had a first legal charge and so it was a breach of the stakeholder agreement to release monies to the developer.

174 Law and Key Manchester argued that, on a true construction, the monies were held to the order of the buyers' company and there was a tripartite stakeholder agreement between the buyers' company, the seller and the seller's solicitor. They submitted that the company alone had the authority to agree to release of stake. The company agreed that the workaround allowed monies to be released by the stakeholder notwithstanding that the company did not have a first charge. 174 Law was, therefore, duly authorised to release the monies.

174 Law also relied on the evidence of Mr Hayhurst, that the directors of the company had agreed at a meeting in December 2015 that 174 Law could release monies as soon as a certificate was issued and did not need to seek further authorisation from the other directors. There was documentary evidence that this had been agreed by March 2016.

174 Law contended that, in giving authority, the relevant individuals at Oliver & Co and Key Manchester were acting in the dual capacity as directors of the buyers' company and solicitors for present and future buyers. This was resisted by Key Manchester, which maintained that the individuals were acting solely in their capacity as directors. This was also the Claimants' analysis.

174 Law argued that if, contrary to its primary case, it was liable to the Claimants it was entitled to a complete indemnity from Key Manchester. In rebuttal, Key Manchester contended that it was not liable to the Claimants and, even if it was, it was not liable for the same damage within the meaning of the Civil Liability (Contribution) Act 1978.

The witnesses

A striking feature of this case was the quality of the witness evidence. The Claimants mostly gave a poor account of themselves. Several of them claimed to need interpreters and translated witness statements when it soon became clear that they did not. One of these had lived and studied for a university degree in New Zealand, another had spent some of his studies in the United States, yet others had taken degree courses in Hong Kong which, they accepted, had been substantially taught in English. One of them described herself as a 'housewife' but it emerged in cross-examination that she was an accountant by profession and that her husband relied on her to make financial decisions.

With two exceptions, the Judge did not find the Claimants *"to be satisfactory or reliable witnesses*". Their statements *"tended to take the form of a standard template, using in large measure the same standard form of words and repeating more or less exactly the same content*" and "*they appeared to be giving pre-planned answers to questions, rather than providing their clear, and genuine recollections*".

The Claimants also accepted in cross-examination that they had either not read the documents supplied by their solicitor at all or had read them cursorily or selectively. Their Counsel put the surprising proposition to one of the solicitor witnesses that clients *"will look at what's on the front page. They might perhaps look at what's on the back page but they are far less likely to look at* *what's hidden in the middle of* [a report on title]". It is hard to see how claimants who conducted themselves in this way could expect to succeed on causation.

By contrast to the Claimants, 174 Law's witnesses were impressive. The Judge described the solicitor witnesses, respectively, as "*a competent solicitor who was doing his best to assist the court…a patently and transparently honest witness,*" "*a competent and honest solicitor who was genuinely doing his best to assist the court*," "*a competent, thoughtful, open, careful and honest solicitor*," and "*an exemplary witness who was patently honest*". He found the former director of the developer to be *"a competent professional, and an honest witness, who was clearly doing his best to assist the court*".

The judgment

The claim against 174 Law failed and the contribution claim against Key Manchester fell with it.

The Judge rejected the Claimants' primary case that the buyers' company was not a party to the stakeholder agreement in its own right but accepted its secondary case that the buyers' company and the individual buyers were parties. He accepted the Defendants' case that the buyers' company alone was the party with the power to authorise release but distinguished between this and the right to enforce the stakeholder agreement.

He concluded that it could not be right that if the stakeholder paid away deposits without the authority of the buyers' company, the company alone and not the buyers whose monies had been paid away, would have a right of action against the seller. One apparent answer to this is that the buyers were members of the company and had rights in company law. A majority of them could compel the directors of the company to act or replace them with others who would do so. If the majority refused to assist a minority, this could be addressed through an unfair prejudice petition. However, these points were ventilated at trial and did not sway the Judge.

The Judge also broadly accepted the Claimants' submissions that the power of the buyers' company to authorise releases was limited by the terms of the Agreements for sale and that the conditions precedent to release, including that the company had a first charge, had to be complied with. However, he concluded that it was for the buyers' company alone to satisfy itself that any preconditions had been met, not 174 Law as stakeholder.

Contemporaneous documents suggested that the directors of the buyers' company agreed to the workaround in their capacity as directors. One of the buyers' solicitors was firm in her evidence that this is the capacity in which she was being asked to and did agree to the workaround.

Nevertheless, the Judge found that it was implicit that the directors were giving authority in their capacity as solicitors for the buyers as well as in their capacity as directors. It followed, he concluded, that while the Claimants might have had a complaint against their own solicitor, they had none against 174 Law. On similar grounds, the Judge accepted 174 Law's secondary case that the Claimants were estopped by convention from arguing that there was a breach of the stakeholder agreement.

The Judge concluded that Mr Hayhurst was mistaken in his recollection that the other directors had agreed his construction of the Agreement for Sale in December 2015, but that agreement was reached in March 2016 and this implicitly ratified any earlier releases made without reference to the other directors.

The contribution claim fell with the claim, but the Judge dealt briskly with the issues in it. Unhappily for defendants minded to resolve claims on commercial grounds, he seemingly accepted submissions that settlement of the Part 7 claims against Key Manchester can be taken as an admission of liability. He also accepted that it is hard to see how, if 174 Law had been found to have paid away monies improperly, Key Manchester would escape liability.

Notwithstanding his findings that the Claimants were unreliable witnesses who gave pre-prepared answers rather than genuine recollection, and admissions that they did not read the documents properly if at all, he accepted for the purposes of the contribution claim their assertion that they would not have agreed to the release of funds if asked in circumstances where the buyers' company did not have a first charge.

The Judge concluded that an unduly restrictive approach to the characterisation of 'same damage' should be avoided and that, applying the statutory language in a broad sense, the damage for which 174 Law would have been responsible had the claim against it succeeded could be said to be the same damage for which Key Manchester was liable. He did not accept that 174 Law would be entitled to a complete indemnity but accepted that losses would be substantially apportioned to Key Manchester.

Notwithstanding these findings, the Judge acknowledged that this may well have resulted in greater liability falling on Key Manchester than that which would have been recoverable as falling within the scope of its duty in the Part 7 claim against it. This appears to be a recognition that if Key Manchester were in breach of duty for failing to advise the Claimants about the priority of the charges, application of *SAAMCO* principles would suggest that their recoverable loss would be the difference between the total loss actually suffered and the recovery the Claimants would have made in the event that the buyers' company had a first charge, *i.e.* about 9p in the Pound

Discussion

In recent years, there has been a proliferation of claims against conveyancing solicitors advanced by groups of individual investors in buyer-funded projects. The majority of claimants pursue their own solicitors, but this cohort was not unique in pursuing the seller's solicitor.

The judgment underscores the difficulty for claimants to succeed in claims against sellers' solicitors and we would trust that it will deter potential claimants from pursuing such claims in future. It also, however, provides some insight into how the courts might approach the more common claims against solicitors acting for buyers.

Application of SAAMCO principles

A high watermark for claimants was the case of *Main v Giambrone* [2017] EWCA Civ 1193 in which the Court of Appeal upheld Foskett J's judgment for the claimants, who were represented by the same solicitors as the Claimants in this action. That case involved the purchase of holiday homes in Italy rather than residential or student apartments in the UK, but there were some similarities in how the transactions were structured.

Among many unattractive features of *Giambrone*, by the time of the trial the site had been seized by law enforcement authorities on suspicion that the project was part of a money-laundering operation by the 'Ndrangheta (Calabrian mafia) on behalf of a dissident IRA splinter group and the solicitor responsible had been struck off.

The defendant solicitors were dual-qualified Italian *avvocati* based in London. They offered something of a one-stop shop for British and Irish investors looking to buy property in Italy. This included promoting Calabria as fast becoming a 'hot spot' for foreign investors, advising on *"all aspects of Italian law*," translating Italian-language documents into English and explaining Italian law concepts which it was assumed the investors would be unfamiliar with, purportedly conducting due diligence over the development and carrying out "*a multiple object investigation aiming at determining the feasibility of the intended purchase".*

The Judge concluded and the Court of Appeal agreed that this was an exceptional case at what should now be seen, following the Supreme Court's decision in *Manchester Building Society v Grant Thornton* [2021] UKSC 20, as one extreme of the *SAAMCO* spectrum where the adviser has assumed responsibility for every aspect of a transaction in prospect for his client. *BPE v Hughes Holland* [2017] UKSC 21 shows that conveyancing solicitors will ordinarily be at the other extreme, where the professional adviser contributes only a small part of the material on which the client relies in deciding how to act.

The factual matrix of this case was unusual, and perhaps unique. Subsequent cases in which we have been involved, including this one can, in our view, clearly be distinguished. Given the nature of the action which ultimately came before the court, the application of *SAAMCO* was not fully argued at trial, but it seems evident from his findings on contribution that the Judge, who was taken to *Giambrone* and cited it on a different point, viewed this case as at the *BPE* end of the spectrum.

Established business model

In light of our investigations, we have long been of the view that the suggestion that there is anything inherently dubious about buyer-funded developments of this sort is unsustainable. It is helpful that there is now a finding of the High Court that, by 2015, this was an established, albeit risky, business model.

It is also notable that, for all the historic allegations about this particular developer, the Claimants made no headway in suggesting that there was anything sinister behind its collapse.

Witnesses

This judgment emphasises the importance of witness evidence. Claimants will obviously frame their case in a manner which would lead them to a recovery. But they have to prove each element of the cause of action, which will include giving a credible account and being unshaken in cross examination.

With the two exceptions rightly singled out by the Judge, the Claimants were not credible and gave pre-prepared answers which they believed would help their case. This, combined with his favourable impression of the defence witnesses, appears to have satisfied the Judge that the merits were not with the Claimants.

In any professional liability claim, the advice given by the professional in documents will be subject to close scrutiny and possibly conflicting constructions. However, as this case shows, it should not be assumed that claimants actually read the advice given or materially relied on it. If they did not read the advice they were given, it must surely follow that they would not have read the advice they say they should have been given.

Relevance of regulatory decisions

Claimants in these sorts of disputes commonly rely on the agreed outcomes between the SRA and Mr Hayhurst and Mr Sewell. Both gave evidence at trial. They were, respectively, the individuals described as a patently and transparently honest witness and a competent and honest solicitor. Mr Hayhurst sidestepped the question of whether he accepted the SRA's assertions by indicating that he could not recall the details. Mr Sewell, however, confirmed that he did not accept them but had agreed them for the purposes of achieving settlement with the SRA.

The agreed outcomes were adduced by the Claimants and relied on by 174 Law on the question of 'liability' for the purposes of a contribution claim. Key Manchester's Counsel submitted that *"The fact that a tribunal constituted in the way that the Solicitors Disciplinary Tribunal is reaches conclusions and particularly makes an order on the basis of agreed outcomes takes a judge of the Chancery Division, with respect, nowhere. It is a matter for this court to decide, as it will, what it makes of the evidence and in my submission very little weight can or should be placed on those findings".* In our view, this is clearly right, and the point would have even more force in a case involving different projects and solicitors. The judge seemingly agreed as he made no reference at all to the decisions in his judgment and determined the point by reference to other factors.

Conclusion

Each case obviously turns on its own facts, but this is a largely helpful decision for defendants, particularly those being pursued in their capacity as seller's solicitors for alleged breach of stakeholder agreement but also more widely.

John Cayton and Richard Senior acted for Key Manchester Limited.

John Cayton
Senior Partner
E: cayton@caytonslaw.com

Richard Senior
Senior Associate
E: senior@caytonslaw.com