Caytons
Changing Perceptions

Duties Owed by Mortgage Brokers: *Taylor v Legal and General*

INTRODUCTION

In *Taylor v Legal and General* [2022] EWHC 2475 (Ch), the court considered the duties owed by a mortgage broker to clients who took out an interest-only mortgage to fund an imprudent investment in what was eventually revealed to be a Ponzi scheme.

This note reviews the judgment

THE FACTS

The background facts had echoes of the solicitors' liability case of *Main v Giambrone* [2017] EWCA Civ 1193, which was brought back to mind in recent weeks with news of Mr Giambrone's return to practice, this time as a member of the Bar.

The developer

As in *Giambrone*, the claim arose from doomed buyer-funded development projects involving overseas holiday accommodation. In this case, the projects were in St Vincent and the Dominican Republic.

It may be recalled that, in *Giambrone,* the project was suspected of being a front for the 'Ndrangheta (Calabrian mafia) to launder money on behalf of the Real IRA and that the site had been seized by the authorities by the time of the trial. There was a similarly unattractive backdrop to the present case. The projects here seem to have had limited existence outside the imagination of the developer's controlling mind. That individual is now serving a 12-year prison sentence for fraud.

The developer operated under the Harlequin brand. It sold various types of overseas holiday accommodation off plan. This was to be built at resorts across the Caribbean. In outline, the transactions were much as one would expect from a buyer-funded development. Investors paid non-refundable[1] fees of £1,000 to reserve their units then 30% of the purchase price on exchange. The price was said to involve a significant discount on the market value of the completed unit. Investors were promised a guaranteed rental income at a 10% yield for a period after completion.

But, from the outset, Harlequin's business model had features which a Judge in earlier proceedings[2] described in the space of six paragraphs as *"startling," "unique," "remarkable," "unsatisfactory," and "beggar*[ing] *all belief*". Marketing material contained what the Judge in those proceedings unhesitatingly described as lies. This included a made-up claim that a City institution had invested £50m in the project and a bogus promise that investors' deposits would be ring-fenced.

In truth, there was no institutional funding. For every deposit paid, Harlequin immediately skimmed off 50% in commission. It treated the balance as at the free disposal of its various companies, including to fund the sponsorship of Port Vale Football Club. It had no formal agreement with its contractor, and no mechanism for

[1] Although the Judge in the present case appeared to suggest that the deposit paid by the Claimants in one transaction was, in fact, refundable

[2] *Harlequin v Wilkins Kennedy* [2016] EWHC 3188 (TCC)

controlling construction costs. The contractor's representatives were able to buy yachts and planes with the money flowing in from Harlequin. A large number of the units sold were to be built on land which Harlequin did not even own, although it claimed that it did. There were uncertainties over such basic matters as planning consent and the electricity supply for the St Vincent scheme. Harlequin's claimed ambitions for the development repeatedly expanded until the number of projected units had increased almost threefold.

The Claimants

Mr and Mrs Taylor lived in a house in Rochdale which, at the relevant time, was probably worth about £160,000. They owed about £26,000 on their mortgage. Mr Taylor came into some money. He inherited £112,000. He, his wife and his siblings clubbed together £172,000 to buy two units off plan in the Harlequin scheme in St Vincent and another at the scheme in the Dominican Republic.

The Broker

Harlequin encouraged its existing investors to buy more units. It offered to introduce them to a mortgage broker to assist them in raising funds secured against their homes. The Taylors took it up on the offer. They consulted Kinsleigh Financial Services Limited ('the Broker''), which was an appointed representative of the Defendant.

They completed a mortgage application in which they asked to borrow £101,000 on an interest-only basis. The monies were to be used to pay off their existing mortgage and put down the deposit on another unit in the St Vincent scheme. They indicated that the capital would be repaid, "*from sale of property in future*".

The Broker's representative recorded (Judge's emphasis):

> "*I have explained the different repayment methods to you and discussed your needs as to whether you require a guarantee that your whole mortgage is repaid at the end of the term, or whether you are prepared to take an element of risk that some of your mortgage may not be repaid. <u>You indicated that you are not concerned about having any form of guarantee that your mortgage is repaid at the end of the mortgage term. I have therefore recommended a repayment method of interest only, where you will pay only the interest charged by the lender and none of the original amount borrowed. You have advised that the amount you originally borrowed will be repaid by the sale of your property in the future</u>. However, this could leave you with a potential shortfall, as the value of your property could go down as well as up.".*

and (Judge's emphasis):

> *"I have recommended a term of 20 years for the amount of your mortgage that is on an interest only basis as this coincides with your existing arrangements in place to repay this amount. <u>Please note that I am unable to advise you on these arrangements and the extent to which they are likely to pay any given amount. If you are unsure about the level of guarantee your investment offers, you should seek independent advice before placing reliance on it to repay all or part of your mortgage</u>..."*

In reviewing the Taylors' means, the representative also identified that their income significantly exceeded their outgoings. The Judge considered this significant.

The demise

Harlequin slowly unravelled. Delays were reported. Assurances were given. Part of the St Vincent scheme was built out, but little or no building work was carried out at the various other resorts. Of the 8,200 investors who sought to acquire units, only about 20 got what they paid for. The Taylors were not among them. Harlequin ended up in litigation with its contractor and accountant. In one of the actions, the developer's controlling mind described himself as a visionary. The Judge dismissed him as, *"more of a Walter Mitty-type figure who, through an unhappy mixture of dishonesty, naivety and incompetence, has caused irreparable loss to thousands of people".*

Eventually, some ten years after the Taylors invested in the projects, Harlequin collapsed into insolvency.

THE ARGUMENTS

Both parties relied on expert evidence. The Claimants' expert maintained that the Broker should have scrutinised and advised on the risks of the proposed investment. He suggested that this should have extended to matters such as the need for an escrow account to stop monies being misapplied. He concluded that a reasonable mortgage

advisor would have recommended a repayment mortgage to reduce the risk, but Counsel went further than that in submissions and contended that the Broker should have insisted that the Taylors took financial advice on the investment and refused to recommend any product to them unless they did.

The Defendant's expert, by contrast, maintained that a mortgage advisor does not have the expertise to scrutinise investment schemes and cannot be expected to give the advice contended for. He added that transactions of this nature were a recognised form of investment at the time and that there was no basis for declining to act or advising against the investment, "*unless it patently represented something akin to an obvious gamble rather than a legitimate investment".*

THE JUDGMENT

The Judge expressed considerable sympathy for the Claimants as victims of fraud. It emerged in evidence that Mr Taylor was the decision-maker and that his wife left matters to him. His evidence was, therefore, key and hers peripheral. The Judge found him to be an honest and impressive witness, but as is becoming increasingly common reminded himself of the *Gestmin* guidelines on the fallibility of human memory over time.

He concluded that it was not within the scope of the Broker's duty to decline to recommend a mortgage unless the Claimants sought independent advice. In doing so, he rejected as too broad the Claimants' formulation of the risk that the duty was meant to guard against as that of suffering a significant reduction in the value of the equity in the property charged. Instead, the Judge framed it as the risk of the Claimants being introduced to a mortgage which was unsuitable because it was not reasonably affordable or was otherwise inappropriate to their needs and circumstances.

Notably, the Judge indicated that 'needs' in this context should be concerned with the requirements of the customer, not with whether the customer planned to apply the monies in a way which might objectively be considered financially prudent.

Factors which led him to this conclusion were that the Claimants were enthusiastic about the investment, the type of investment was "*by no means exceptional,*" a mortgage broker cannot be expected to be in a position to identify what might be a good or bad investment, the Broker had warned that it could not advise on the adequacy of repayment arrangements and that the Claimants should seek advice if uncertain, that it would have been an unreasonable restriction on the Claimants' autonomy as consumers for the Broker to make any recommendation conditional on them taking financial advice, that Mr Taylor accepted that it was *"plausible*" that the project might not be completed, and that the Claimants had a sufficient excess of income over outgoings to meet the mortgage payments in any event.

The Judge did not consider there to be any merit in the Claimants' alternative case that the Broker should have recommended a repayment mortgage. He dealt with the point shortly, noting that the Claimants had reasons for wanting to minimise monthly repayments and emphasising again that there was a fallback in the form of excess income.

He went on to indicate that, if he were wrong on duty and breach, a case on causation "*might conceivably be made out"* that the transaction would not have proceeded. But in circumstances where the Claimants were enthusiastic about the proposed investment, he concluded that it was more likely than not that they would have gone ahead even if they had been warned about the risks involved.

He added that, even if the Claimants had made out a case on liability, it was hard to see on what basis the loss of the capital invested in the Harlequin schemes could properly be said to fall within the Broker's scope of duty in accordance with the principles outlined in *Manchester BS v Grant Thornton*.

The Judge left until last what might be thought to be the first question arising and concluded that, even if the Taylors had had a good claim, it would have been time-barred in any event.

DISCUSSION

The decision is clearly welcome for mortgage brokers and their insurers. It ought to have a chilling effect on claimants contemplating similar claims. It does, however, leave open to argument whether the result might be different where borrowers do not have the fallback of excess income. The judgment also has wider lessons.

Application of *Manchester BS*

As a postscript to our recent series on the application of *Manchester BS v Grant Thornton*, this case provides a further illustration of the court policing the boundaries of a professional's scope of duty and rejecting expansive formulations of the risk the duty was meant to guard against. It again shows losses being excluded by application of 'the duty nexus question,' despite suggestions in some quarters that the Supreme Court had emasculated *SAAMCO*.

Sympathetic claimants

The Judge's sympathy for the Taylors as the victims of fraud did not distract him from a clear-eyed application of the law in favour of the Broker. This mirrors the judgment in the accountants' liability case of *Knights v Townsend Harrison* [2021] STC 2119 (Comm), considered in our series on *Manchester BS*, where an investment opportunity turned out to be a Ponzi scheme. One would expect the court to be even less inclined to adopt a broad-brush merits-based approach where the failure of a scheme was down to misfortune or mistaken commercial decisions.

Claimants' autonomy

The court's recognition of the Claimants' autonomy as consumers is welcome.

Where, as here, claims arise from failed investments, there is a tendency for claimants to deny themselves agency and proceed rather as if they were children who need a responsible adult, in the form of a conveniently insured professional, to warn them not to run into the road.

It would, of course, be open to them to seek an opinion from a financial adviser if uncertain about the investment. But, if they neglect to do so, it should not be for other professionals who are not engaged, or even necessarily qualified, to evaluate the investment to second-guess the client's decision-making and give advice about its prudence. As the Privy Council put it in the solicitors' liability context in *Clarke Boyce v Mouat* [1994] 1 AC 428:

> *"When a client in full command of his faculties and apparently aware of what he is doing seeks the assistance of a solicitor in the carrying out of a particular transaction, that solicitor is under no duty whether before or after accepting instructions to go beyond those instructions by proffering unsought advice on the wisdom of the transaction. To hold otherwise could impose intolerable burdens on solicitors."*

Investors' mindsets

Another common feature of claims about investments gone wrong is for claimants to reconstruct their mindset at the time of the transaction with the benefit of hindsight. In their recollection, the promised returns become of secondary importance and risks their overriding concern. This need not involve them lying, as the *Gestmin* guidelines acknowledge, but invites scepticism.

When a client comes to a mortgage broker for assistance on finding funds for an investment opportunity, or for that matter to a solicitor to carry out the transaction to implement it, the client has already satisfied itself that the investment was an attractive opportunity and one in which they were prepared to invest money. As we all do when shopping online or paying deposits and call out charges for future work, the client has necessarily formed a judgment that the counterparty is a reputable business which will keep its end of the bargain and, therefore, that the inherent risks can be discounted.

Looking at the matter properly, in prospect, and without the benefit of hindsight, it is unconvincing to suggest that the client would have walked away if warned by a professional as to what might happen if it all went wrong. Here, as in *Townsend Harrison*, the court readily accepted that the claimants would have gone ahead regardless.

CONCLUSIONS

This is a welcome judgment both for its immediate application to claims against mortgage brokers, but also for a more general insight into the courts' approach to claims arising from failed investments. It is one of a series of recent cases where the courts have rejected expansive arguments about the scope of a professional's duty and the losses falling within it.

Further Information

Given the generality of the note it should not be treated as specific advice in relation to a 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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