A costly error

Failure to advise clients of risk can have serious financial consequences. David Greene and Dominic de Bono consider a recent equitable compensation claim

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Equitable compensation for breach of trust aims to provide the pecuniary equivalent of performance of the trust. The extent of equitable compensation should be the same as if damages for breach of contract were sought at common law: equity seeks to compensate for the performance loss caused by the breach of trust. Equitable compensation is a personal monetary remedy available for equitable wrongs such as breach of trust, knowing receipt or breach of confidence. *Main v Giambrone & Law* [2017] (*Giambrone*) focused on equitable compensation in the context of breach of trust. A claim for equitable compensation for breach of trust is limited to losses flowing directly from the breach.

Most claims for breach of trust will be 'stand-alone' claims; the only possible claim a beneficiary has against the trustee will be for breach of trust. But it is possible for there to be concurrent claims in contract and tort. When applying the equitable rules of compensation in *Giambrone*, equitable compensation and contractual damages were found to run in tandem.

Giambrone: the facts

The relationship between the IRA and the Calabrian mafia, the infamously violent Ndrangheta, provides a racy background to a recent decision in the High Court on the more mundane concepts of equitable compensation. While the police carried out raids round the world seeking to bust up the criminal operations, prospective purchasers of holiday homes were litigating in London over the recovery of their money that had been sunk into the criminal operation.

The target of their claim was Italian lawyer Gabriele Giambrone. He operated a firm of Italian lawyers practising Italian law in London and Italy (Giambrone & Law, referred to as 'Giambrone'). He and his partners were found to be negligent and in breach of trust in their advice given to hundreds of claimant purchasers. The transactions in question were the purchase, by English and Irish investors, of holiday properties on the Italian coast in Calabria, called Jewel of the Sea (JoTS). The claimants were successful at first instance. Giambrone appealed to the Court of Appeal. The appeal judgment provides lessons for solicitors on the scope of their duties and on the principles of equitable compensation. Giambrone failed to warn clients of the potential for criminal conduct in Calabria and clients paid over deposit monies that were then lost.

This fascinating case provides clear lessons for solicitors on the scope of their duties and on the principles of equitable compensation. *Giambrone* is the first case where solicitors have been held liable for the full consequences of their failure properly to advise their clients of the risks involved in a purchase. Solicitors must conduct matters in a manner best to protect purchasers from the associated risks. Solicitors who undertake wider obligations than the standard obligations may find themselves liable for their client's wider losses should they breach those obligations.

The focus of this article is on the principles of equitable compensation, but the Court of Appeal judgment should be referred to as a whole and each subject considered by the court should not be viewed in isolation.

The claimants paid substantial deposits to Giambrone: 50% of the individual purchase prices for the off-plan apartments. The firm then paid out those deposits, 62% as commission to the promoter (VFI) and 38% to the developers.

When problems arose with the planning permission, construction work stopped and the Italian Financial Police took possession of the development following allegations of a money-laundering operation because of its links to serious organised crime.

The claimants were left without their holiday homes and without their deposits. They had been promised guarantees issued by Italian financial institutions to protect the deposits that they paid if the developers entered a specific form of insolvency. The guarantees were not in the event issued by the right institutions and ended prematurely. The 185 claimants as part of a group action sued Giambrone, in relation to its conduct of 119 attempted purchases of properties in JoTS, for negligence and multiple breaches including breach of trust.

It was held that the majority of claimants should recover equitable compensation for breach of trust in the form of the full amount of their deposits.

First-instance decision: March 2015

Foskett J held that Giambrone had breached its duty of care to the JoTS purchasers. This breach occurred by failing to tell the purchasers that the guarantees were not compliant, failing to advise of the adequacy of the preliminary contracts and failing to carry out appropriate checks in relation to planning permissions or adequate due diligence.

The judge held that Giambrone was in breach of duty to the claimants in eight respects:

- Failing to tell the claimants that the guarantees did not comply with Italian law.
- Failing to advise on the inadequacy of the terms of the preliminary contract, particularly the apparent inability of the purchasers to terminate the contract for delay.
- Failing to undertake any checks additional to looking at the face of the planning permission. Failing to make any inquiry into the intrinsic validity and integrity of the planning permission.
- Paying commission to VFI out of the deposits without telling the clients the amount payable to VFI. Giambrone should have told clients about the division at the outset and did not. It concealed the existence of the mandates and therefore the level of commission payable to VFI. Failing to disclose the commission payable to VFI was also a breach of the implied duty to seek informed consent to the withdrawal of client money under r22(1) of the Solicitors' Accounts Rules and payment out in those circumstances was a breach of trust.
- Failure to carry out adequate due diligence.
- Failing to advise the purchasers that the non-returnable deposit of 50% of the purchase price was unusually high and failing to explain the reasons for this.
- Permitting the claimants to part with and paying out the deposits when guarantees extending to the completion date were not in place. The fact that the guarantees were issued by a lower grade of financial institutions should have been drawn to the attention of the purchasers and should have led to no deposits being paid out. Payments were accordingly made in breach of trust, breach of contract and breach of the duty of care in tort.
- Failing to alert purchasers to the risks of criminal activity in the construction industry in Calabria in appropriate terms, and to undertake enquiries into such activity.

Foskett J found that it was a breach of trust for Giambrone to pay out deposits to the promoters and the developers. This finding was not challenged at the appeal.

Application for summary judgment

Following this decision, summary judgment was given to the claimants on quantified loss. It was held that the majority of claimants should recover equitable compensation for breach of trust in the form of the full amount of their deposits.

The effect of the summary judgment, which focused on breach of trust, is emphatically not to make the appellants 'underwriters for any loss which the claimants suffered in respect of their investments in the development' regardless of causation. Rather it is to hold the appellants liable to restore to the respondents the lost value of their deposits, which they should never have paid away.

Court of Appeal

The central question arose as to how the court should assess equitable compensation for breach of trust. This appeal was argued on 27 and 28 June 2017.

The principal issues of appeal were:

- whether the claimants were entitled to equitable compensation for their lost deposits; and
- whether the losses suffered were within the scope of lawyers' duties when acting on a property transaction.

The appeal in relation to breach of trust turned on three key points:

- the term of the trust upon which Giambrone held the deposits was essentially negative, *viz* not to pay out the deposits unless certain conditions were fulfilled;
- Giambrone breached that term by paying out when the conditions had not been fulfilled; and

- in circumstances where those conditions were never subsequently fulfilled in relation to any of the money held on trust, performance (and thus equitable compensation for failure of performance) could only proceed on the basis that the deposit monies should have been retained by Giambrone.

In terms of the trust that bound the firm, the deposits should not have been paid out unless and until a compliant guarantee was in place, and since that situation never arose the proper performance of the trust obligations would never have led to the monies being paid out. Accordingly, it was submitted that Giambrone was accountable for the monies paid out, because, the trust monies having been misapplied, the trustee (here the firm) must restore the trust fund to the position it would have been in if the firm had performed its obligation. The practical effect may be no different from simply saying that the beneficiary (here the relevant purchaser) should be compensated directly for the consequences of the breach of trust. The purchaser was entitled to be put in the position that they would have been in if the terms of the trust had been implemented.

As ever in negligence claims and the assessment of damages flowing from the wrong, a central issue to the appeal was the *SAAMCo* cap (*South Australia Asset Management Corp v York Montague Ltd* [1997]).

The *SAAMCo* cap has the effect of limiting the professional's liability to a sum equal to the difference between the negligent value and the true value of the property. In the case of a solicitor, the negligent value the property was attributed is on the basis of the information they provided in relation to it.

Five grounds of appeal

Permission to appeal was granted on five grounds, the judge observing that they raised serious issues which merited argument on a full appeal.

Those five grounds were the following:

- The judge erred in awarding equitable compensation, because even if Giambrone had obtained guarantees complying with Decree 122 of Italian legislation (which protects purchasers of properties not yet built), the claimants would have recovered nothing under those guarantees in the circumstances which arose.

- The judge erred in finding that Giambrone's payment of commission to VFI, without informing the claimants of the level of commission, was a breach of trust.

- The principles formulated in *SAAMCo* prevented the claimants from recovering part or all of their deposits either as damages for breach of contract/negligence or as equitable compensation for breach of trust.

- Giambrone checked that apparently valid planning permissions were in place for JoTS. It was not under a duty to do more.

- Giambrone was under no duty to warn the claimants that in Calabria there was a risk of criminal activity in the construction industry.

Jackson LJ held that the present case was not a conventional conveyancing situation. The claimants had no knowledge of Italian law and conveyancing procedures. Their lawyers did and controlled the information and decided how and when to release it to the claimants. They guided the whole decision-making process: what protection was needed, what monies they should pay out and when. In particular, they had advised the claimants that they would be adequately protected by the non-compliant guarantees.

Lord Hoffman in *SAAMCo* had broken down the work that a professional might provide into two categories of duty:

(1) where a person is under a duty to take reasonable care to provide information on which someone else will decide upon a course of action; and

(2) where a person is under a duty to advise someone as to what course of action they should take which includes an obligation to take reasonable care to consider all the potential consequences of the course of action.

The SAAMCo cap has the effect of limiting the professional's liability to a sum equal to the difference between the negligent value and the true value of the property.

In cases falling within category 1, if the person is in breach of that duty, Lord Hoffmann concluded that the defendant is generally only responsible for the consequences of the information being wrong. It would be unfair to impose liability for losses which would have occurred even if the information they had provided had been correct.

In cases falling within category 2, if the person is in breach of that duty, Lord Hoffmann said that the defendant is generally responsible for all the foreseeable loss which is a consequence of that course of action having been taken.

The Court of Appeal found that Giambrone's duty fell into category 2: to receive the deposits and hold that money as custodian until the developers provided compliant guarantees, and also to receive the guarantees and check whether they were compliant with Decree 122. Only if compliant guarantees were received was Giambrone entitled to release the deposits. As compliant guarantees were never obtained, the deposits should not have been paid out and Giambrone was in breach of its retainer in doing so. The court emphasised that trust was an essential part of the machinery for the performance of that contract.

Jackson LJ held that the contractual measure of damages should be the amount of the deposits, because those monies were now lost. In this case, equitable compensation and contractual damages ran in tandem.

Court of Appeal: key case law

Three authorities proved to be central to the submissions on equitable compensation:

- *Canson Enterprises Ltd v Boughton & Co* [1991];
- *Target Holdings Ltd v Redferns* [1995]; and
- *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2015].

In *Target* we are usefully provided with a summary of equitable compensation in which to frame the Court of Appeal judgment in *Giambrone*:

> The basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law. Thus, in relation to a traditional trust where the fund is held in trust for a number of beneficiaries having different, usually successive, equitable interests, (e.g. A for life with remainder to B), the right of each beneficiary is to have the whole fund vested in the trustees so as to be available to satisfy his equitable interest when, and if, it falls into possession. Accordingly, in the case of a breach of such a trust involving the wrongful paying away of trust assets, the liability of the trustee is to restore to the trust fund, often called 'the trust estate', what ought to have been there.

In *Target*, Lord Browne-Wilkinson cited the judgment of McLachlin J in *Canson* as correctly stating the relevant principles. He held that equitable compensation makes good the loss suffered by the beneficiaries 'which, using hindsight and common sense, can be seen to have been caused by the breach'.

In *AIB* the Supreme Court held that principles of equitable compensation required the trustee to restore the trust fund, if still in existence, to the position in which it would have been but for the trustee's breach and, if the trust was no longer subsisting, to pay compensation to the beneficiary on the same basis.

In AIB the Supreme Court held that principles of equitable compensation required the trustee to restore the trust fund, if still in existence, to the position in which it would have been but for the trustee's breach.

The essential difference between this case and *Target* or *AIB* is the solicitors' role in relation to the security. It was not the function of Giambrone to liaise with the providers of the guarantees. Giambrone had no input into the drafting of the guarantees or any of the other formalities under Italian law. Giambrone's role was to receive whatever guarantees the developers provided and to check whether or not they complied with Italian law. If (and only if) the guarantees did comply, then the firm was under a duty and entitled to release the deposits. In the language of Lord Toulson in *AIB*, that was 'the content' of the 'relevant obligation'.

The position was distinguished from that in *Target* and *AIB*. In *Target* the solicitors were under a duty to take active steps to secure a charge over the property, before releasing the monies. In *AIB* the solicitors were under a duty to take active steps to secure the removal of prior charges before releasing the money. In *Giambrone*, the firm's obligation was to act as custodian of the deposit monies for an indefinite period. Compliant guarantees never appeared. Absent them Giambrone should have remained as custodian of the deposit monies until the preliminary contracts were rescinded, and then paid those monies back to its clients.

It was held that if the solicitors had complied with their duty not to release the deposits unless compliant guarantees had been provided the claimants would not have suffered their losses. The deposits would have remained in the solicitors' client account. Accordingly, the case turned on the characterisation of the solicitors' obligations.

The appeal judgment is notable as it applies the Supreme Court decision in *BPE Solicitors v Hughes-Holland* [2017], which considered the scope of duty of a firm of solicitors and the relevant test as to whether their duty comprised information or advice.

BPE

Lord Sumption gave judgment in *BPE*. He recognised that the case concerned 'one of the main dilemmas of the law of damages'. He emphasised that a defendant whose obligation was to provide information, even critical information, which would be relied upon by a claimant in deciding how or whether to proceed, was only liable for the consequences of that information being wrong.

Lord Sumption rebutted well-known criticisms of *SAAMCo*, restating the difference between an information duty and an advisory duty. He decided that *BPE* was an 'information' case. Undoubtedly BPE had breached its duty. Lord Sumption asked what if any loss was attributable to that breach. The answer was that even if the information given by BPE had been right, the client would still have lost money, because the development would have failed in any event. As a result the loss was not within the scope of BPE's duty. It arose from commercial misjudgements, which were no concern of theirs.

In a review of the principle in *SAAMCo* Lord Sumption stated that this principle is a means of restricting a defendant's liability for loss, which is not based on causation. Rather it, and other principles which limit a defendant's liability, are based on a 'developed judicial instinct about the

Recommended further reading

- 'Unique Rules for the Unique Institution, the Trust' in Degeling & Edelman (eds), *Equity in Commercial Law* (2005).
- Jackson and Powell 8th edition – first supplement: see 11-241.

nature or extent of the duty which the wrongdoer has broken'. The relevant question is whether the loss which is claimed 'flowed from… the particular feature of the defendant's conduct which made it wrongful'.

Lord Hoffmann's advice/information distinction was said to have given rise to confusion because of the descriptive inadequacy of the labels.

Lord Sumption explained the relevant distinction as follows:

- An 'advice' case, in which a professional will be liable for all the foreseeable consequences of a transaction entered into upon negligent advice, will only arise where the professional owes a duty to consider all relevant matters and not only specific factors within a client's decision – ie a case where the professional is responsible for guiding the whole decision-making process, and is responsible for the decision itself.

- An 'information' case is one where the professional contributes a limited part of the material on which their client will rely when making a decision, but the overall assessment of the commercial merits of the transaction is for the client. In such a case the professional will be liable only for the financial consequences of the information which they provided being wrong, even if the information was critical to the decision of whether to enter into the transaction. Limiting the professional's liability this way is essential as:

> Otherwise the defendant would become the underwriter of the financial fortunes of the whole transaction by virtue of having assumed a duty of care in relation to just one element of someone else's decision.

In *Giambrone* Jackson LJ considered the application of these principles.

The key issue is that in a category 1 case (referred to above), the measure of damages is the foreseeable loss which arises as a consequence of the information being wrong. If, on the other hand, it is a category 2 case, then the measure of damages is all foreseeable losses which have arisen as a consequence of a client relying on the advice and proceeding with that course of action.

Jackson LJ restated the principle as follows:

> The true distinction between categories 1 and 2 does not depend upon information or advice. The distinction lies in whether [the Defendant] is guiding the whole decision making process or merely providing part of the material on which [the Claimant] will rely… In a category 2 case 'it is left to the advisor to consider what matters should be taken into account when deciding whether to enter into the transaction'… Valuers and conveyancers usually fall into category 1. They provide part of the material on which the client bases its decision.

Applying these principles to the facts, Jackson LJ held that this was a category 2 advice case, noting that this was not a 'conventional conveyancing situation'. While the purchasers had taken the decision to purchase a property in Italy, after that they were reliant on Giambrone. The purchasers were buying properties abroad and had no knowledge of the local Italian law or conveyancing procedures. Giambrone had decided what information the claimants required and provided this to them. The content of the retainer letter and subsequent correspondence had guided the purchasers' decision-making process as Giambrone was telling the clients what protection they required, what sums they should pay and when (in reliance on the insufficient guarantees) they should pay out that money.

Although Jackson LJ disapproved of the terms 'information' and 'advice' cases, he observed:

> … obviously the claimants decided whether or not they wanted to buy holiday homes in Southern Italy. But having taken that primary decision, they put themselves into the hands of Giambrone as their experienced Anglo-Italian lawyers.

The loss of the deposits was held to be within the scope of the solicitors' duty.

Conclusion for practitioners

The Court of Appeal held that Giambrone provided advice beyond the conventional obligations of solicitors and by taking on wider obligations became liable to the claimants for the losses suffered. This is the first case where solicitors have been held liable for the full consequences of their failure to properly advise their clients of the risks involved in a conveyancing purchase, and gives useful guidance for legal professionals as to how they should conduct matters in a manner so as to protect the purchasers from the risks involved. It gives practical examples of how a retainer letter should be carefully drafted and a solicitor should be careful not to exceed these standard obligations.

The relevant question is whether the loss which is claimed 'flowed from… the particular feature of the defendant's conduct which made it wrongful'.

The *Giambrone* judgment offers a warning to conveyancing lawyers who undertake wider obligations than the standard as they now might find themselves liable for their clients' wider losses. If nothing further this case should serve as a warning to practitioners to take extra care in the new post-*BPE* era. ■

AIB Group (UK) plc v Mark Redler & Co Solicitors
[2015] WTLR 187
BPE Solicitors & anor v Hughes-Holland
[2017] UKSC 21
Canson Enterprises Ltd v Boughton & Co
[1991] 3 SCR 534
Main & ors v Giambrone & Law & ors
[2017] EWCA Civ 1193
South Australia Asset Management Corp v York Montague Ltd
[1996] UKHL 10
Target Holdings Ltd v Redferns
[1995] UKHL 10