DRN-3426047

## The complaint

Mr and Mrs O complain about their mortgage with Paratus AMC Limited trading as Foundation Home Loans. They say it has added excessive legal fees to their balance.

## What happened

Mr and Mrs O took out an interest only mortgage with Foundation's predecessor company in 2005. The mortgage was over a 25 year term, and they borrowed £323,000. The balance is now over £350,000 with less than ten years of the term to go. Mr and Mrs O are in their sixties.

In 2020, Mr O's income was impacted by the coronavirus pandemic, and they took a payment deferral. Towards the end of 2020, Mr O suffered an accident and had to give up work altogether. Mrs O was herself unwell and off work at this time, and also had to start caring for Mr O.

Mr and Mrs O asked their son-in-law to liaise with Foundation on their behalf. They say he offered to pay a nominal sum in full and final settlement of the outstanding balance, in view of Mr and Mrs O's circumstances. They say their son-in-law told them Foundation had accepted that offer, and they stopped making payments from January 2021 on his advice.

In fact, Foundation had not accepted a settlement offer. It wrote to Mr and Mrs O several times to warn them the mortgage was going into arrears and asking them to discuss payment. Mr O says he didn't see those letters because of his condition and because he was in and out of hospital. And Mrs O accepted the advice of their son-in-law that they no longer had to make any payments.

When it didn't hear from Mr and Mrs O and payments were still not being received, Foundation instructed solicitors to begin possession proceedings. In May 2021 Mr O says he received a letter from the solicitors – which was the first time he learned what had been going on with the mortgage. At the beginning of June, he got in touch with Foundation himself to resolve things.

Foundation says that Mr and Mrs O had authorised their son-in-law to act on their behalf. In December 2020 he sent a cheque to Foundation for £10, endorsed with the words *"Banking this cheque means it is accepted as full and final settlement of the debt with mortgage account number [Mr and Mrs O's account number]"*.

Foundation said that this did not mean that it accepted £10 in settlement of their mortgage, and the mortgage remained outstanding and Mr and Mrs O had an ongoing obligation to pay it. It had written to Mr and Mrs O and their son-in-law explaining that. But their son-in-law had written back threatening legal action, and asking for the matter to be referred to Foundation's lawyers. As there was a threat of legal action against Foundation, it referred things to its solicitors. The solicitors wrote to Mr and Mrs O and their son-in-law restating that the mortgage was not settled and that they did not believe a court would agree it was. It advised them to get their own legal advice before taking things further.

Foundation also told Mr and Mrs O by letter that their mortgage was in arrears and needed to be brought up to date. Mr and Mrs O's son-in-law again wrote to Foundation saying that the mortgage had been settled and if Foundation did not recognise that, they would take legal action against it.

As payment was still not being made, and Mr and Mrs O's son-in-law continued to assert that the mortgage had been settled, Foundation instructed its solicitors to start repossession action against Mr and Mrs O.

In June 2021, Mr O contacted Foundation to remove authority for their son-in-law to speak on their behalf. He asked Foundation to consider things again. He provided income and expenditure information and medical evidence about his and Mrs O's conditions. As a result, Foundation agreed to withdraw the possession proceedings on the basis that Mr and Mrs O paid £50 a month for the next three months. This was a temporary arrangement to give Mr and Mrs O some breathing space, and a more long-term arrangement would then need to be agreed.

The proceedings were adjourned, and Mr and Mrs O did start making payments again. But Foundation added its costs of dealing with this situation to the mortgage balance.

Mr and Mrs O complain that Foundation has added around £20,000 of legal costs to the mortgage balance. They say that if there is a dispute, it's about whether or not there was a contract between Foundation and their son-in-law to accept full and final settlement and any legal costs arising out of that are a matter between Foundation and their son-in-law; Mr and Mrs O are not responsible for them. They say Mrs O wrote to Foundation in February and March 2021, when she received its letters, to say that she understood the mortgage had been settled and they no longer needed to pay anything – but Foundation never replied.

Mr and Mrs O say Foundation didn't warn them it was going to add legal fees to the mortgage, and that it any case it wasn't reasonable for it to instruct external solicitors rather than using its own staff or legal department. Had it written to Mr and Mrs O saying that it had not agreed to settle the mortgage, none of this would have happened.

Mr and Mrs O also don't agree that Foundation is entitled to add its costs to the mortgage balance under the terms and conditions. And as no proceedings were ever issued, there was no need to add legal costs. They also say that in any event the amount of the costs is unreasonable and disproportionate, and Foundation ran up costs by asking the solicitors to do work – such as reply to letters – it should have done itself. They suspect that Foundation and the solicitors are colluding to inflate costs and defraud borrowers. And they say as a matter of law pre-action costs are not recoverable from the other party, so Foundation has no right to expect them to cover its costs.

Mr and Mrs O want Foundation to remove the legal costs from their mortgage balance to settle this complaint.

Foundation said that it had been threatened with legal action saying that a debt of £350,000 was no longer recoverable. It had to take that seriously, and it was reasonable to instruct its solicitors to deal with that threat. Mr and Mrs O had authorised their son-in-law to speak on their behalf, but they were ultimately responsible for what was being done on their mortgage in their name. It said it was reasonable to begin possession proceedings when no payment had been made, it was told no more payments would be made, and the arrears were growing. It said the legal costs incurred were reasonable in the circumstances, and it was entitled to add them to the mortgage balance.

Foundation said that it knew nothing of Mr and Mrs O's health concerns until Mr O got in touch in June 2020; before then, all it knew was that Mr and Mrs O were disputing whether they still owed anything and refusing to make payments. If it had known sooner, it might have thought again about whether to start possession proceedings – but it couldn't act on information it didn't have. And ultimately it was up to Mr and Mrs O to manage their mortgage and to discuss things with Foundation if they couldn't.

However, Foundation said that in recognition of the circumstances, and because Mr and Mrs O were no longer suggesting the mortgage had been settled, it would reduce the legal fees by £5,000.

Our investigator didn't think Foundation had acted unfairly, so Mr and Mrs O asked for an ombudsman to review their complaint.

**My provisional decision**

I issued a provisional decision setting out my thoughts on the complaint. I said:

> I'm sorry to hear of Mr and Mrs O's very difficult personal circumstances, and everything they've been through. I'd like to reassure them I've taken full account of that in deciding the fair and reasonable outcome of this complaint.
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> I can understand why, in late 2020, Mr and Mrs O felt unable to manage things themselves and asked their son-in-law to deal with the mortgage on their behalf. This was around the time of Mr O's serious accident, and Mrs O was herself unwell but having to care for Mr O.
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> So I'm sure they were very grateful when he offered to help them manage things. Mr and Mrs O signed an authority authorising their son-in-law to speak on their behalf and liaise with their lender.
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> That means that their son-in-law was acting for them and on their behalf, and as their agent. They are still responsible for this mortgage and the outstanding debt, and are also responsible for everything their son-in-law said and did on their behalf.
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> Unfortunately, their son-in-law chose not to help them by explaining their situation to Foundation and seeing whether there was anything Foundation could do to help them.
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> Instead, he decided to pursue a spurious and legally hopeless argument. He sent Foundation a cheque for £10, and said that by cashing it Foundation would be accepting it in settlement of the entire mortgage debt.
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> I don't know if Mr and Mrs O were aware of what was going on at that point – if their son-in-law explained exactly what he was doing, or just reassured them that everything was under control.
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> The sad fact was that in fact things weren't under control. Instead of helping them at a very difficult time, their son-in-law had made things immeasurably worse for Mr and Mrs O.
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> Ultimately, though, even if in fact Mr and Mrs O didn't know what he was doing, they had appointed him to act on their behalf as their agent. As a matter of law, they are responsible for what he did in their name. If he acted beyond their knowledge or agreement, that – and the consequences of it – is something they will need to take

up with him. It seems his hopeless and misguided actions have cost Mr and Mrs O a lot of money and a great deal of upset.

But there's nothing I can do about that. I have no jurisdiction over Mr and Mrs O's son-in-law. All I can consider in this decision is whether Foundation have treated them fairly in all the circumstances.

As I say, Mr and Mrs O authorised their son-in-law to deal with Foundation on their behalf. Foundation had no way of knowing whether or not Mr and Mrs O knew what was going on. But it did take steps to make sure that they did. Even though they had asked it to do so, it didn't just deal with their son-in-law – it also sent all correspondence to Mr and Mrs O directly, both correspondence rejecting his claim that the mortgage had been settled, and correspondence warning them of the consequences of the mortgage not being paid.

It seems that because of his health concerns Mr O didn't see any of this correspondence. And Mrs O was reassured by her son-in-law that there was nothing to worry about, so took no action other than writing to Foundation saying she believed the mortgage had been settled.

But even though Mr and Mrs O didn't know or didn't appreciate what was being done in their name, it was being done. Foundation received threats of legal action insisting that it write off a debt of £350,000. In those circumstances it was reasonable that it asked its solicitors to respond to the threatened legal action on its behalf – as in fact Mr and Mrs O's son-in-law asked it to do.

And when the mortgage remained unpaid, and Foundation received no communication from Mr and Mrs O other than continued assertions from their son-in-law, and letters from Mrs O, that the mortgage no longer existed, it was left with little choice but to bring legal action to recover the mortgage through repossession.

It had tried telling Mr and Mrs O's son-in-law that there was no merit in his arguments. It had tried contacting Mr and Mrs O. But no payments were being made, the arrears were mounting, and it seemed to Foundation at that time that Mr and Mrs O had no intention of ever making any payments again. In those circumstances, it's difficult to see what else it could have done other than start repossession action.

By this point, Mr O was back home from hospital and saw correspondence from Foundation's solicitors and realised what had happened. He was able to get in touch with Foundation and agree to start making payments again, and start repaying the arrears. He also explained what had been happening and his and Mrs O's health concerns.

Following these discussions, Foundation was reassured and agreed to withdraw the repossession proceedings. Thankfully Mr O was just in time to stop his son-in-law's irresponsible approach to the mortgage costing them their home.

As I say, given what it was told and what it knew at the time, it was reasonable for Foundation to instruct its solicitors both to respond to Mr and Mrs O's son-in-law's threats of legal action, and to begin possession proceedings itself.
I therefore need to decide whether it was fair for Foundation to go on to add its costs to Mr and Mrs O's mortgage balance – and, if it was, whether the amount of costs was reasonable.

The starting point for considering that is the mortgage agreement itself. The mortgage terms and conditions say that Mr and Mrs O

> "*must pay our expenses when we ask for them … all expenses will be charged to the mortgage account and form part of the amount owed.".*

The word "expenses" is defined as

> *"all reasonable costs and expenses we have to pay in connection with the mortgage. These include costs and expenses which we pay:*
> - *Recovering all or part of the amount owed;*
> - *Bringing or defending legal proceedings relating to amount owed, the property or any other security for the amount owed;*
> - *Protecting, preserving or enforcing any security for the amount owed;*
> - *Remedying any breach by you of any of your obligations under the mortgage.*
>
> *…*
>
> *Our expenses include costs and expenses which we have to pay to third parties and our administration fees in respect of our internal costs as set out in our tariff."*

What this means is that where Foundation incurs costs in managing the mortgage, it's entitled to recover them from Mr and Mrs O, and do so by adding them to the mortgage balance.

Mr and Mrs O say that there weren't any legal proceedings, and as a matter of law pre-action costs aren't recoverable from an opponent. That's true, as a statement of the general legal position. But in this case there were legal proceedings – Foundation had issued a repossession claim, though it never went to full trial.

And in any case, the general rule is that a court won't award pre-action costs when making a costs order at the end of a case. But that's not what is happening here. Foundation is not relying on costs following the event in a court case, or a court awarding costs.

Instead, Foundation is relying on what's known in law as a contractual indemnity, which means that – regardless of the usual legal position in other cases – Mr and Mrs O agreed, under the terms and conditions of this mortgage, to cover all Foundation's costs. Even if it couldn't recover its legal costs from Mr and Mrs O in a court case, it's still entitled to recover them in this case, because the mortgage terms and conditions say it can.

I don't agree that this is a dispute between Mr and Mrs O's son-in-law and Foundation, with the costs of it to be sorted out between them. As I said above, Mr and Mrs O's son-in-law was acting as their agent, on their behalf, in dealing with their mortgage lender about their mortgage. That means that, in law, they are responsible for what he did on their behalf – and if he exceeded their authority, that's a matter between him and Mr and Mrs O.

In any case, even if this was a dispute between Mr and Mrs O's son-in-law and Foundation independently of Mr and Mrs O – which it isn't – it was about Mr and Mrs O's mortgage. And the terms and conditions I've quoted above allow Foundation to

recover costs of “bringing or defending legal proceedings” (which in my view includes threatened proceedings) whether or not Mr and Mrs O are party to those proceedings. Mr and Mrs O’s son-in-law was threatening to bring legal proceedings relating to the amount owed, and the terms allow Foundation to recover its costs in defending itself against that.

I’m therefore satisfied that it was reasonable in principle for Foundation to instruct it solicitors to deal with Mr and Mrs O’s son-in-law’s threat of legal proceedings, and to add the costs of doing so to their mortgage balance.

The final point I need to deal with is whether the amount of the costs was reasonable. In total, Foundation added around £20,000 to the mortgage balance, including in relation to the possession proceedings.

I’ve seen the invoices from its solicitors, and they relate to work done in March and April 2021 in relation to Mr and Mrs O’s son-in-law’s claim that the mortgage had been settled – for which just under £17,000 was incurred. A further £3,500 was charged in June 2020 for work done in connection with the possession proceedings.

The £17,000 includes over 50 hours spent by Foundation’s solicitors, together with almost £5,000 spent on advice from counsel. So I’ve thought very carefully about whether this is a reasonable amount – and I asked Foundation and its solicitors for further information about what exactly was done.

Having considered everything here, I’m satisfied that – by and large – the actions of the solicitors were reasonable. They were largely engaged in corresponding with Mr and Mrs O’s son-in-law – including replying to correspondence from him – and advising Foundation of its legal position. Most of that was driven by the need to respond to contact from Mr and Mrs O’s son-in-law, and so I’m satisfied that was reasonable.

However, I’m not satisfied it was necessary for the solicitors to seek advice from a barrister at a very early stage, as happened in this case. Had Mr and Mrs O’s son-in-law carried out his threat to issue legal proceedings, it would have been reasonable to instruct a barrister to represent Foundation in court.

However, in this case a barrister was instructed to advise on the law rather than to defend Foundation in court. I’m not persuaded this was necessary – especially in view of the groundless nature of the legal claim and the seniority and experience of the solicitor involved in advising Foundation (who claimed time for researching the legal position herself in any event). In response to my queries, Foundation and its solicitor didn’t offer a specific justification of the need for advice at this stage (even though this was one of the questions I asked), nor have I seen the advice given.

I don’t therefore think that it is reasonable for Foundation to pass on the costs relating to the instruction of the barrister to Mr and Mrs O’s mortgage account.

Having reviewed the detailed breakdown of work done, it seems to me that the following items relating to the barrister’s instruction should not be charged to Mr and Mrs O:

- 22 March – emails totalling £74
- 23 March – preparing bundle, internal emails and internal calls re bundle for barrister, emails to barrister’s clerk – total £610.50

- 24 March – email to barrister's clerk - £37
- 25 March – updating barrister - £92.50
- 26 March – drafting instructions to barrister, emails with clerk - £814
- 31 March – considering barrister's opinion and emails - £203.50
- 31 March – barrister's invoice - £4,000

This totals £5,831.50 – adding VAT brings it to £6,997.80.

Foundation offered to reduce the legal fees charged to the account by £5,000. For the reasons I've given, I don't think this goes far enough. But I don't think I can fairly uphold the wider complaint that Foundation was not entitled to add legal costs at all.

**The responses to my provisional decision**

Mr and Mrs O's daughter responded to my provisional decision on their behalf. She said:

- The £10 settlement offer is a matter between the son-in-law and Foundation, not Mr and Mrs O. But the son-in-law would agree to drop his argument if Foundation came to a settlement;

- Foundation was in fact aware of Mr O's health situation by April 2021 – yet still took possession action. This, and the amount of the legal fees it claims, shows its aggressive tactics;

- Foundation has not given Mr and Mrs O a copy of the signed mortgage agreement – without that, they don't agree the terms and conditions are binding on them;

- They don't agree that Foundation has actually incurred the legal costs – unless it provides proof of payment in the form of bank statements, not just invoices;

- They do not agree that the terms and conditions allow costs to be claimed on the indemnity basis. But in any case, costs have to be reasonably incurred and reasonable in amount;

- Foundation's solicitors sent eight letters and emails to Mr and Mrs O's son-in-law, which is not enough to justify the costs claimed. The content is repetitive and not technical and much of the work could have been done by Foundation or its in-house solicitors;

- They disagreed with the reasonableness of work claimed on the invoices, and dispute that it was necessary for much of it to be done by a qualified solicitor – who "went to town" in an excessive and unreasonable way;

- There are mathematical errors on the invoices;

- Insisting on doing everything through solicitors made things not only more expensive but also more stressful for Mr and Mrs O;

- The rules of court provide that where a VAT registered firm can recover VAT as input tax, it is not entitled to recover VAT from a paying party as part of a costs award. For the same reasons, Foundation should not be entitled to add VAT to the legal costs it has added to their mortgage balance;

- They do not accept that they are liable for these costs at all. But in the interests of resolving the matter, would accept a reduction to £3,000;

- Foundation is effectively a loan shark, profiting off ordinary borrowers for the benefit of private investors based overseas and avoiding UK taxes

Foundation also responded. It did not agree that it was premature or excessive to instruct counsel to advise given what it described as the "serious and potentially fraudulent" actions of a third party, who had also tried to get its security removed from the Land Registry. Foundation was entitled to take action to protect its position, and to charge the costs of doing so to the mortgage account. However, it said that in the interests of resolving the complaint and moving on, it would agree to reduce the fees added to the balance by the amount I had set.

Foundation also said that it was proper for it to include VAT on the amount it added to the loan balance since it was not entitled to recover VAT.

**What I've decided – and why**

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I've carefully considered everything again, taking full note of the detailed points Mr and Mrs O's daughter has made on their behalf (which I've only summarised above). However, having done so, I don't intend to depart from the overall conclusions I reached in my provisional decision.

There seems to be some confusion between a contractual indemnity, and the indemnity basis for assessing costs.

A contractual indemnity means that, under the terms of a contract, one party agrees to cover – indemnify – the other party's costs. I've set out above the specific part of the mortgage terms and conditions by which Mr and Mrs O agreed to cover any costs Foundation incurred, and which entitled Foundation to add its costs to the mortgage balance.

The indemnity basis is an approach the courts use for assessing costs awarded in a legal case. There are two ways of assessing costs – the standard basis and the indemnity basis – and without going into unnecessary detail, the difference between them is essentially which party is entitled to the benefit of the doubt in the assessment process.

The courts have said that in considering costs subject to a contractual indemnity, the indemnity basis is to be preferred. But those things are not the same.

In any case, my view is that, as a matter of law and as a matter of what's fair and reasonable in all the circumstances, Foundation is entitled to recover costs which are reasonably incurred and which are reasonable in amount, and that's the key question I have to decide.

I'm satisfied, for the reasons I gave in my provisional decision, that it was reasonable for Foundation to instruct solicitors to advise it and to protect its position.

As far as Foundation was concerned, Mr and Mrs O had stopped paying their mortgage and had asked their son-in-law to engage with Foundation to assert that the mortgage had been settled for £10 and Foundation was no longer entitled to recover the mortgage. The son-in-law was also trying to get Foundation's charge removed from the Land Registry, and was strongly arguing that Foundation was not entitled to any further payment.

It was reasonable, in the situation as Foundation understood it at the time, to ask its solicitors to deal with the assertive and legalistic (if wrong) argument Mr and Mrs O's son-in-law was making, which was accompanied by threats of court action, attempts to remove its charge, and what appeared at the time to be deliberate withholding of payment.

I accept that Foundation became aware of Mr O's health situation by April, rather than June. But even before that, Mrs O had written to it directly adopting her son-in-law's arguments and refusing to make payment. So it was reasonable for Foundation to think that Mr and Mrs O's position was that Foundation was not entitled to any further payments and Mr and Mrs O didn't intend to make any.

Also around April, and perhaps becoming conscious of the hopelessness of his arguments and the consequences to Mr and Mrs O of pursuing them, their son-in-law tried to back down and to negotiate a rather higher settlement figure than £10 – though rather less than the loan balance.

By this time, given the situation, Foundation was contemplating taking repossession action, a matter appropriately left to its solicitors.

Taking all that into account, I'm satisfied that it was reasonable that Foundation instructed its solicitors to deal with the arguments Mr and Mrs O's son-in-law was making, and to deal with the repossession action it started in light of their failure to make payments.

It was only later, when Mr O got involved, that a proper discussion of the true position happened – and at that point Foundation agreed a temporary reduced payment arrangement and paused the possession proceedings. I think that was fair.

I'm satisfied that Foundation actually incurred these costs, and I don't think it's necessary for me to ask it to provide proof of the funds leaving its bank account before I can make that finding.

I'm also satisfied that the costs were reasonably incurred. Much of the work the solicitors did at first was reactive, responding to Mr and Mrs O's son-in-law. Though later, it also began possession proceedings, acting on Foundation's instructions because of the missed payments, mounting arrears, and lack of sensible contact from Mr and Mrs O.

For the same reasons I gave in my provisional decision, I don't think it was necessary for the senior solicitor to research the legal position herself, and then also ask counsel to advise on it. There was a practical necessity to respond to him and his threats of legal action, but I don't think it was necessary to seek detailed advice from counsel at that stage.

However, other than that, I'm satisfied the costs claimed were reasonably incurred and reasonable in amount. I don't agree that this was a dispute between Foundation and Mr and Mrs O's son-in-law on his own behalf. He was acting for and representing them – and even if he wasn't, under the terms of the mortgage contract Foundation is entitled to recover the costs of defending itself and protecting its security, whether or not it was doing so against Mr and Mrs O.

Even if Mr and Mrs O don't have a signed copy of the mortgage agreement, and Foundation hasn't provided them with one, I don't think that changes the position. There's no dispute that Mr and Mrs O borrowed this money and entered into a mortgage with Foundation.

The courts have found that the absence of a signed mortgage deed does not invalidate the mortgage or make it unenforceable. And in any case, whether a mortgage contract is technically enforceable as a matter of law is a matter for the courts, not for me. I'm satisfied

that Mr and Mrs O borrowed the money from Foundation, agreed to give security for the money they borrowed and agreed to Foundation's lending terms. I'm satisfied that it's fair and reasonable to treat them as bound by the mortgage.

It's correct that there are some minor errors on the invoices – where the totals in the narratives don't match the total costs claimed. However, I'm satisfied a reasonable explanation has been given for that, and I don't think that affects Foundation's ability to recover those costs.

I'm afraid I don't agree that Foundation was not entitled to include VAT on the costs it added to the balance. It's true that where a party is entitled to recover VAT as input tax from HMRC, it should not also seek to recover it from a third party (such as Mr and Mrs O). However, that's subject to tax law. In particular, VAT registered firms are not entitled to recover VAT on "exempt supplies". Schedule 9 of the Value Added Tax Act 1994 says that supplies relating to financial services, including the granting of any credit, are exempt supplies.

That means that anything Foundation does in connection with its mortgage lending business – the granting of credit – is an exempt supply. That means Foundation cannot recover VAT that it pays out as input tax. And therefore, because it cannot recover it as input tax, it can recover it from Mr and Mrs O.

**Putting things right**

I'm therefore satisfied that – provided the underlying fees are reasonably incurred and reasonable in amount – it's fair and reasonable for Foundation to include VAT on those fees. And, for the reasons I've given, with the exception of costs relating to the instruction of the barrister to advise on Mr and Mrs O's son-in-law's initial assertion that the mortgage had been settled, the costs incurred were reasonably incurred and reasonable in amount.

To put matters right, Foundation should remove the costs relating to the instruction of the barrister. I have itemised them in my provisional decision, quoted above, and in total they are £5,831.50 – adding VAT brings it to £6,997.80. Foundation should remove that amount from the mortgage balance, together with any mortgage interest charged since it was added.

**My final decision**

For the reasons I have given, my final decision is that I uphold this complaint and direct Paratus AMC Limited trading as Foundation Home Loans to remove £6,997.80 of legal costs from Mr and Mrs O's mortgage balance, together with any mortgage interest charged on those costs since addition. This includes, and is not in addition to, the £5,000 that Foundation previously offered to remove.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr and Mrs O to accept or reject my decision before 18 July 2022.

Simon Pugh
**Ombudsman**