large or particularly intricate. Rather, hedging strategies on the institution's proprietary liability (that is, in legal terms, its own personal liabilities) are organised on the basis of the entire swap book. The institution considers the broad range of its exposure, sometimes by currency or by type of business, and then sets in place hedging arrangements to contain that exposure within acceptable limits. Thus hedging is fluid and generally not contract-specific.

For the Court of Appeal to seek a nexus between the agreement with the local authority and the hedging agreement with a third party would necessarily be a difficult task. Tracing any asset through such a mixture would be similarly complicated.

However, the proper analysis of an interest rate swap, based on the analysis set out above, might show that it is possibly not a single executory contract in any event. The courts are assuming that there is one single contract (because the point is not being taken before them) and therefore looking for a hedge that operates in the same manner. When the interest rate swap is seen to be what it is, an amalgam of debts which may or may not crystallise, the nexus between the hedge to the original interest rate swap agreement perhaps seems less opaque.

The better approach might be to assess whether the risk assumed by the bank is one which the bank sought to address through hedging arrangements which were not a requirement of the agreement any more than it was a requirement of the agreement for the local authority to procure further risk management protection. The defence should only be available in those terms where the risk of passing on is within the common intention of the parties. In *Kleinwort Benson* the plaintiff's hedging strategy was the result of a unilateral decision. The outcome of the Court of Appeal's decision appears to achieve a just result in those terms, but the reasoning behind it appears to open as many issues as it resolves. By restricting itself to the classical discussion of passing on, the Court of Appeal is failing to appreciate the context of modern portfolio theory.

**ARTIFICIAL RESTRICTION**

The reasoning behind the Court of Appeal's decision appears to open as many issues as it resolves. By restricting itself to the classical discussion of passing on, the Court of Appeal is failing to appreciate the context of modern portfolio theory.

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# Land Law

## The fight against gazumping

by Professor M P Thompson

The new government, as part of its general reforming zeal, has decided to review the conveyancing procedures in England and Wales and, in particular, to seek to stamp out the practice of gazumping which, apparently, after the recent and prolonged slump in the property market, has returned to cast its shadow over the conveyancing scene. The practice is well known and almost universally frowned upon. In short, the vendor agrees, subject to contract, to sell a house to the purchaser for, say, £70,000 and then subsequently refuses to exchange contracts unless the purchaser raises the price to £75,000 – usually because a higher offer has been made by another party. If the purchaser refuses to meet the new asking price, he or she is out of pocket as a result of incurring expenditure on search fees and a survey. The purchaser understandably feels aggrieved and considers that compensation should be available although the law at present offers no such remedy. The question which arises is whether some change in the law could usefully be made.

**PURCHASER'S COMPENSATION**

Changing the law to allow the purchaser compensation would certainly be seen by some as an improvement. A difficulty in the way of such a proposal is, however, its somewhat one-sided nature which may result in hardship to the vendor.

The enthusiasm to revisit the problem may be new but the difficulties in tackling it have been recognised for some considerable time. Probably the first occasion that gazumping came to public attention was the introduction, in 1971, by Kevin McNamara MP of the Abolition of Gazumping and Kindred Practices Bill. As is the usual fate of Private Members' bills, this did not reach the statute book; but the matter was referred to the Law Commission, who declined to recommend any legislative change. It is interesting to consider some of the proposals which were considered to determine what course of action, if any, might now be considered to be appropriate.

### POSSIBLE REMEDIES

One option is to make the practice of gazumping a criminal offence. Apart from the very real problem of defining such an offence, there is a serious objection in principle. It is not generally a criminal offence to break a contract. This being the case, it is difficult to see any justification for the criminalisation of a refusal to enter a binding contract. The criminal law should, it is submitted, have no place in the present context.

An alternative to the imposition of criminal sanctions is to require the vendor to compensate the purchaser for expenditure which the latter incurs if the vendor seeks to back out of the deal. At present, the law will only award such compensation in unusual cases of pre-contractual expenditure and certainly only where the expenditure is that normally incurred in a conveyancing transaction – see *Regalian Properties plc v London Docklands Development Corporation* [1995] 1 All ER 1005. Changing the law to allow the purchaser compensation


would certainly be seen by some as an improvement.

A difficulty in the way of such a proposal is, however, its somewhat one-sided nature, which may result in hardship to the vendor. Consider a case where A is seeking to move house and has found an attractive property owned by C. All is dependent upon the sale of A's own house. P, having inspected A's house, makes an offer to buy it, and this offer is accepted, subject to contract. A then makes an offer to buy C's house, which is accepted, again subject to contract. A then commissions a survey on C's house. P, having commissioned his own survey on A's house, then pulls out of the transaction because A will not reduce the price which had been agreed, subject to contract. This then causes the proposed purchase of C's property to fall through. Although A will not have to compensate P for his pre-contract expenditure, neither will he be able to claim from either C or P in respect of his own expenditure. In this scenario, it is A who will feel aggrieved, having been 'gazundered' by P without any entitlement to compensation from him. This practice became familiar during the worst of the property slump.

## PRE-CONTRACT DEPOSITS

The obvious answer to this is to insist that, where there is an agreement which is subject to contract, both parties pay a pre-contract deposit to a stakeholder. This deposit is forfeit to the other side if one party pulls out of the transaction.

The introduction of such a system was recommended by both the Law Commission and by the Farrand Committee. One advantage of such a scheme is that, unlike the position where compensation is available, further action to actually recover that compensation is unnecessary: the aggrieved party simply recovers the deposit. The Farrand Committee recommended the taking of a pre-contract deposit of 0.5%, while current thinking seems to favour the much larger figure of 5%. There are problems with both practices, particularly the latter, where, if a person was selling a house for £100,000 and buying another for the same figure then, before any legally binding commitment was entered into, a sum of £10,000 would have to be paid, representing £5,000 in respect of each transaction. Clearly, this is a large sum of money which the vendor may be unwilling or unable to find.

There are also other practical problems. An integral part of the scheme recommended by the Farrand Committee was to recognise that there exist situations, such as the receipt of an unsatisfactory survey, when the purchaser should be able to withdraw from the transaction without losing the pre-contractual deposit. Another occasion for withdrawal without penalty would be where either party could not proceed with the projected transaction because of inability to exchange contracts on a linked transaction. The ability to withdraw with impunity weakens the scheme's utility as an anti-gazumping device but is essential in the interests of justice as the following scenario demonstrates.

A agrees, subject to contract, to sell his house to B for £100,000 and also agrees, subject to contract, to buy C's house for £120,000. He is then made redundant, can no longer afford to pay the increased mortgage on the proposed purchase and so, reluctantly, pulls out of the two transactions. If the pre-contract deposit system was in force, and A was unable to withdraw from the transactions for cause then, in addition to losing his or her job, A would also lose both of the pre-contract deposits that had been paid. Perhaps examples such as this help to explain why the voluntary scheme of pre-contractual deposits has not been widely adopted.

## THE FUTURE

The root of the gazumping problem lies in the fact that in England, unlike Scotland, it is normal for conveyancing transactions to be linked with, at times, lengthy chains being formed. Inevitably, this will cause delays in the formation of binding contracts and so it is difficult to see that the frustrations attendant upon these delays can be obviated. While few would defend the morality of gazumping, in general, there are situations where such a course of action may be free from condemnation. Suppose a situation where A has agreed, subject to contract, to sell his house to B for £100,000; but B's ability to enter a binding contract is dependent upon his or her ability to sell his or her own property and that the prospects of this do not seem good. A then receives an offer from C, a first time buyer, to buy the house for £105,000. As the prospects of a quick sale seem to be excellent and will enable A to enter a formal contract to buy D's house, it would take a good deal of will power on A's part to reject C's offer and wait for B to sell his or her house and also risk losing the projected purchase of D's property. If A does accept C's offer, which is highly understandable, B will have been gazumped.

**DEPOSIT SCHEME**

The ability to withdraw with impunity weakens the scheme's utility as an anti-gazumping device but is essential in the interests of justice.

Gazumping is an issue which generates understandably strong emotions. It would seem, however, to be an inevitable by-product of the necessarily prolonged time period which affects chain transactions. While this may appear to be a somewhat conservative approach, it is suggested that any legislative attempt to seek to eradicate the practice may well do more harm than good.

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