MARSH

CLIENT ADVISER

THE HAZARDS OF HANDLING CLIENT MONEY

Holding client money and then paying it out carries risk for any business. A recent rise in criminal activity targeting client money has increased risks for law firms, which could be found liable if this money ends up in the wrong hands as a result of crime or fraud.

The recent court case, *Dreamvar (UK) Limited v Mishcon de Reya* [2016] EWHC 3316 (Ch) (*Dreamvar*), concerns payment of client money, and has received considerable attention. The Court refused to release Mishcons, in their capacity as trustees, from liability for payment of client money in breach of trust, even though they were found not to be negligent.

The case involved the sale of an unencumbered West London freehold mews house, allegedly being sold rapidly due to the owner's divorce. In the course of a conveyancing transaction, the firm, acting for Dreamvar (the buyer), made a payment of client money (approximately GBP1 million) to a law firm, whose client, Mr. Haeem (the seller), was found to be an impostor. The buyer's firm was sued for breach of trust by the buyer and failed to obtain relief from the Court under s61 Trustee Act 1925 (s61) that the breach of trust ought fairly and reasonably to be excused, as the firm acted honestly and reasonably.

In *The Times*[1] the firm were quoted as recognising the Court as being bound by the decision (also subject to an appeal), in *P&P*[2]. That case reiterated the view that the seller's solicitor does not warrant the identity of their client, but only that they have instructions to act as agent from a person. The seller's solicitors in *P&P* were not liable to the buyer or their solicitor when, having carried out normal checks, they acted for an impostor. According to a briefing note by BLM solicitors[3], who handled the successful defence of the solicitors in *P&P*, in refusing to order the Defendant to pay the buyer's solicitors:

"The judge noted that in *P&P*, it was open to the buyer's solicitors to have sought undertakings that the seller's solicitor would only release monies to their client on confirmation that they had carried out due diligence, but did not do so."

BLM solicitors also commented in the same article:

"In the light of this judgment, solicitors for buyers might seek to protect their clients by carrying out enquiries about the right of the seller to sell.

The case of *Purrunsing*[4], reported last year, was referred to and distinguished in *P&P*, as that proceeded under a different version of the Law Society's Code for completion.

WHAT DOES THIS MEAN FOR FIRMS?

The current view of the Court set out in Dreamvar (although subject to appeal) is that on the facts, those seeking relief under s61 who have taken reasonable (and in no way negligent) steps may discharge the burden of showing they acted honestly and reasonably, but still may not necessarily convince the Court to excuse the breach of trust, or exercise its discretion to grant relief. In refusing to exercise its discretion, some of the key factors were:

- The significant effect of the refusal or grant of the discretion.
- The comparative financial positions of Dreamvar and Mischons. Dreamvar was seriously affected and had no insurance, while Mischons was better able to absorb the loss with or without insurance.
- There was no remedy against the seller's solicitors. If there had been, the judge indicated he would have granted relief to the extent of the liability found against the seller's solicitors, but no such liability was found.
- The Court said "it is not irrelevant that Mischons was necessarily far better placed ... to consider and as far as possible achieve... greater protection for Dreamvar against the risk which did in fact occur".

The Law Society has published a link to the Lawtel judgment, and indicated that it may issue additional guidance about identity fraud, and intervene in the litigation[5].

WHAT ARE THE CONSEQUENCES?

Law firms often handle client money as a core service. Almost all practice areas can hold significant client money, and cover for the exposure is a significant part of the professional indemnity policy. The consequences of paying the wrong party or a fraudster could be severe, and traditional checks and balances should therefore be reviewed to ensure that they are still adequate.

WHICH AREAS ARE MOST AT RISK?

It is known that criminals often target conveyancing, the proceeds of estates, and commercial transactions. However, any area handling client money could be at risk of such activity. Solicitors are expected to be aware of the threat of fraud and respond accordingly, by warning clients about risk and mitigating where possible.

WHAT CAN FIRMS TO DO MITIGATE THE RISKS?

Although it is not necessarily negligent *not* to do so, it is fairly easy to ask (in appropriate cases) that a firm acting for a seller provides an undertaking that identity checks have been carried out, and are clear, and warn the client of the risks if the request is refused (as well as of the limitations if the undertaking is provided). Although requests for such undertakings are unlikely to be accepted by a seller's solicitors, a refusal, coupled with a warning to the client, might have led to a different result in the Dreamvar case. The standard expected varies with the kind of breach of trust, so a hard and fast view is also difficult to find, but in the case of *Nationwide Building Society v Davisons*[6], the Court said:

"[It] only requires [the trustee] to have acted reasonably. That does not, in my view, predicate that he has necessarily complied with best practice in all respects. The relevant action must at least be connected with the loss for which relief is sought and the requisite standard is that of reasonableness not of perfection."

Insurance can provide a partial solution, at least in the conveyancing area, where suitable title insurance may cover the risk. This is often available, and historically has been reasonably cheap. It seems that there is not much more that could be done to protect and inform the client of this risk if a buyer client was told (and there was evidence they understood):

- The property is unencumbered and/or vacant (or is otherwise a high-risk case for specific reasons discovered, or has high-risk features as referred to in the Law Society's practice note in Property and Registration Fraud 2010) and so is known to be a target for fraudsters.
- The seller's solicitors have refused to give an undertaking, but confirm they have done normal checks on the seller and there are no concerns.
- Title insurance which covers the risk is available and could minimise the impact if the seller is a fraudster.
- If you do not obtain title insurance, there is a greater risk that all the money may be lost.

Where firms can demonstrate that they appreciated and responded appropriately to the known risk of fraud and anything revealed by enquiries, and the client was in an informed position about the risk and steps taken to mitigate it, they are more likely to discharge the burden of proving they acted reasonably, and also persuade the Court to exercise its discretion.

Alternatively, where a relatively inexperienced client is subject to a severe known risk in a transaction and not warned of a potential disastrous outcome, the discretion may not be exercised.

LESSONS LEARNED

The cases mentioned demonstrate the expectation that solicitors respond to new threats and trends in addition to assessing the individual risks of a case, and advise clients accordingly. To remain relevant, firms' risk management strategies need to include control mechanisms by which current barriers and mitigants are assessed to ensure they are effective in preventing these new threats. Firms can do this by:

- Ensuring that firm-wide communications inform solicitors of the need to think about the particular risks (with special attention to high risks) of any individual piece of work which may need to be treated differently.
- Developing procedures to collate external and internal news on liability, claims, circumstances, complaints, and near misses, and taking account of that collated information by:
  - Circulating at practice group level, and soliciting feedback on the impact.
  - Formally reviewing the effectiveness of existing preventative measures, and changing them as necessary.

To discuss your requirements, or any risk management issues, please call one of our experts or contact:

JOHN KUNZLER
john.kunzler@marsh.com
44 (0)20 7178 4277

Footnotes:

1 "Lawyers count cost of £1m fraud ruling" The Times Business 1 February 2017.

2 *P&P Property Limited v (1) Owen White and Catlin LLP (2) Crownvent Limited t/a Winkworth [2016] EWHC 2276 (Ch).*

3 http://www.blmlaw.com/news/-the-acts-of-imposters-where-8217-s-the-liability

4 *Purrunsing v A'Court & Co (a firm) [2016] EWHC 789 (Ch).*

5 Law Society may intervene in landmark fraud case (judgment available in link in the article) 6 February 2017: https://www.lawgazette.co.uk/law/law-society-may-intervene-in-landmark-fraud-case/5059690.article

6 *Nationwide Building Society v Davisons* [2012] EWCA Civ 1626, [2013] PNLR 12 – per Sir Andrew Morritt C.

GRAPHICS NO. 17-0189