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Nightmare on Any Street Dreamvar Part 2

We all enjoy a sequel, and the recent appeal decisions in *Dreamvar* and *P&P Property Ltd*¹ had the appearance of being part of a saga, like a horror movie franchise, which could go all the way to the highest court. This briefing follows on from our earlier communication “The Hazards of Handling Client Money²”, which considered the case at first instance. With the ramifications potentially going beyond conveyancing, this drama was worth watching until the final scene. It appears that there will be no further appeal, so now that the action has drawn to a close, this briefing looks at some practical steps.

With the Court of Appeal having conducted a thorough analysis of the legal processes at play, many firms have woken up to a different reality than was accepted – at least as far as the conveyancing process is concerned:

- Even though no negligence was found, the solicitors acting for the fraudulent seller both cases were not excused liability for technical breach of trust in respect of the innocent buyers.
- Although dismissed due to lack of evidence of reliance, in the *P&P* case, the seller’s solicitor was found to have given and breached a warranty of authority in respect of the identity of their client.

Potentially, some of the findings might also apply in other areas where client money is paid over to third parties. Both the ease with which warranties as to identity might be given, and the construction of the undertaking in paragraph 7(i) of the Law Society Code for Completion by Post 2011 (the “Code”) given by the seller’s solicitors before completion, are also likely to have surprised many practitioners.

The construction of the undertakings given by seller’s solicitors on completion may in any event not be of long-term significance in conveyancing. The indication from the Law Society is that it is likely to update the Code and associated documents. The Law Society’s response to the case on its website indicates³: “The ruling provides valuable guidance on Law Society’s Code for Completion by Post, which was a central feature of the case. That will be reflected in the work to update the Code for Completion and associated documents, which is currently underway.”

Reference:

- 1 *P&P Property Ltd v Owen White & Catlin LLP and another; Dreamvar (UK) Ltd v Mischoon de Reya and others* [2018] EWCA Civ 1082.
- 2 “The Hazards of Handling Client money” at <https://www.marsh.com/uk/insights/research/client-adviser-the-hazards-of-handling-client-money.html>.
- 3 <https://www.lawsociety.org.uk/news/press-releases/dreamvar-law-society-response/> accessed 18th May 2018.

The judgment itself was complex, tackling various causes of action and the facts of two similar cases. The properties concerned were both unmortgaged and if not before, then at least now, such properties are widely known to be a target for identity fraudsters.

While the case has caused much concern in the conveyancing world, this kind of fraud mainly affects unmortgaged residential property, and comfortingly in this context, mortgaged property is less often targeted. This is probably because the fraud is harder to achieve in relation to a mortgaged property, and would generate less money, as the fraudulent seller would only obtain net proceeds.

However, the ramifications of the judgment may go beyond conveyancing. As mentioned in the previous note², some of the findings in relation to breach of trust are likely to be relevant (or argued to be relevant) in relation to other areas of legal work. For example, commercial property, private client, and trust and estates work, are all areas where payment in breach of trust and identity fraud of one kind or another may occur. Obviously, this kind of fraud involves setting up a convincing false identity. Rightly or wrongly, the risk of being taken in by that false identity rests with the solicitor to some degree. Many of the conveyancing checks designed in the 19th and 20th century, which are now the fabric of legal processes, were designed to verify identity and ownership. However, firms are now faced with different and more frequent threats in relation to identity fraud, and it seems firms may need to amend processes further to establish ownership of clients (for those selling), and on behalf of buyer clients.

Processes to establish identity, especially in higher risk cases, must be carried out to a high standard, as this is the key point of failure. The standard of documentation accepted in Dreamvar by the seller's solicitor to establish identity and for anti-money laundering (AML) checks or was considered inadequate by the Court of Appeal. Once through the identity check, from the fraudster's point of view, they are likely to succeed with the fraud, so this is a critical risk point. Firms are all subject to legal requirements to establish identity and source of funds as a result of money laundering prevention directives. However, there should be no confusion here: undertaking AML checks is not reaching any required standard as far as the client is concerned, and is only of passing significance in considering the firm's duty to its client. The standard checks are a bare minimum and only suitable for standard cases. Even so, to manage the growing risk of identity fraud, establishing identity must not be treated as a box ticking exercise, and needs to be executed with similar thoughtful care as reviewing the title.

The judgment has a lot of moving parts – overturning the previous decision in part, and finding the seller's solicitor in both cases liable, in relation to some of the various causes of action.

This briefing aims to provide a very brief overview of those causes of action and some risk management thoughts:

Negligence

No negligence was established against the seller's solicitors in both cases, or against the buyer's solicitor in the Dreamvar case, and against the selling agents in the P&P case. The Court of Appeal held that no duty of care was owed to the innocent purchasers and it would not be fair, just and reasonable (given the facts of the case) to treat the solicitors or the estate agents as having assumed responsibility to the buyers for the adequacy of their AML checks to ascertain the identity of their client.

Breach of warranty of authority

On the particular facts, there was a breach of warranty of authority by the seller's solicitor. When they drafted the contract on behalf of the seller, the seller's solicitors warranted that their client was the person described in the contract. However, the buyer's solicitor in the P&P case gave evidence that this warranty was not relied upon and thus the claim against the seller's solicitor for breach of warranty of authority was dismissed. The decision of the Court below (where there was also evidence the warranty was not relied upon) in relation to Dreamvar, dismissing the claim for breach of warranty of authority by the seller, was not appealed.

Signing the contract as agent for the seller may have had some impact on this position, but this was not argued. The factual matrix of statements made, taken together, is the basis for finding a warranty has been given.

Breach of trust

Breach of trust was established against the seller's solicitors on appeal in both cases (and the buyer's solicitor remained bound by its admission of breach of trust in the Dreamvar case). Neither the buyer's nor the seller's solicitors were relieved of liability for breach of trust. It is surprising that Mishcon de Reya were not relieved from liability for breach of trust. The dissenting judgment from Lady Justice Gloster, Vice-President of the Court of Appeal (Civil Division), shows the Court was divided on this point.

Breach of undertaking

The undertaking on completion (as construed by the Court) provided the buyer with a strong and effective measure of protection against the fraud. The Court interpreted paragraph 7(i) of the Code and said that the seller's solicitors provided an undertaking to the effect that their client is the registered or real owner of the property to be sold and the claims were allowed in both cases.

RISK MANAGEMENT STEPS

Aside from the legal implications, there are also risk management considerations that arise, across both firms and individual practice areas. There are a number of ways that the profession and its clients remain exposed to this type of identity fraud.

Level	Threat Area	Risk Controls/Response
Firm-wide	Standard risk processes may not be sufficient for high risk retainers (e.g. high value, areas known to be targeted by identity fraudsters); such cases may need to be treated differently from lower risk areas.	<p>Across all areas, higher risk matters need to be identified and managed appropriately.</p> <p>Risk controls need to be reviewed against current threats to see if they are adequate to meet the increased threat.</p> <p>For higher risk retainers, additional checks as to identity and supporting documentation may be required.</p>
	Identity fraud is made easier by casual use of technology, coupled with inadequate security of personal data. It has increased dramatically in the last decade.	<p>A high level of vigilance and checking is justified, and AML and other identity processes need to be undertaken with rigour.</p> <p>Any increased checking for higher risk retainers must be completed to a high standard.</p> <p>Reminders and training to raise awareness about latest trends can help reduce the risk of becoming a victim of crime.</p>
	Authority and identity of clients may be false or assumed.	<p>Given the Court's approach, firms should warn fee earners of the risk of unintentionally creating warranties as to the identity of clients in the course of dealing with a matter.</p> <p>Template letters should be reviewed and firms should consider inserting language confirming that no warranty as to identity is given.</p>
	Undertakings enable transfer of significant client funds and so create opportunity for fraudsters.	<p>Significant loss can emerge if the terms of the undertaking, or the professional indemnity insurance of the firm giving the undertaking proves inadequate. Controls over:</p> <ul style="list-style-type: none"> • Who can give or accept undertakings. • Up to what level (additional sign-offs as value increases). • How the drafting is reviewed. <p>All the above need to be updated and monitored.</p>
Conveyancing departments	Most transactions are straightforward house moves involving a mortgage, estate agents, a chain, and known clients, but significantly increased risk controls are required where high value and equity are involved.	<p>Where there are red flags, warnings should be given and additional due diligence undertaken.</p> <p>Red flags could include:</p> <ul style="list-style-type: none"> • Unmortgaged property. • Property not occupied by the seller. • Swift sale required. • Property not on market long. • Overseas seller and or buyer. • No chain. • No agents. • Records from purchase not provided/unavailable. • Only contact details provided are a telephone number and/or an email address. • The client is reluctant to answer questions from the solicitor or from the buyer.
	Such transactions need to be identifiable so that additional risk measures can be applied and monitored consistently.	<p>For sellers' solicitors:</p> <ul style="list-style-type: none"> • Increased due diligence on clients to establish identity is needed, including: <ul style="list-style-type: none"> – Electronic identity checks. – Obtaining records from purchase of the property now being sold. – Reviewing AML documents originally supplied for purchase file. • Review how to prevent warranties as to identity being given: <ul style="list-style-type: none"> – Standard wordings exclusions/limitations. – Warnings/reminders to fee earners.

Level	Threat Area	Risk Controls/Response
Conveyancing departments		<p>For buyers' Solicitors (for suitable cases):</p> <ul style="list-style-type: none"> • Prior office copy search results and other randomised verifying information from the seller from their prior purchase transaction could possibly be requested, as a genuine seller would be expected to possess these or be able to produce them. • Warnings to clients that the property has high-risk features and proceeding could have the result that the money is lost. • Warnings and attempts to restrict liability may be difficult to rely upon where the subject matter is complicated and a client has not had the benefit of independent legal advice. • Where a fraudulent sale occurs, evidence of understanding of risks by, and informed consent to proceed from, the client is likely to assist any firm. • Where seeking relief from breach of trust, firms are likely to be in a better position if the insurance options have been explained (at the time of writing, some insurance is available) and warning given as to the risk that all the money may be lost.

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