

Dreamvar: The Final Chapter?

This briefing follows on from our earlier communications “The Hazards of Handling Client Money”¹ and “Nightmare on Any Street Dreamvar Part 2”². There have been no further appeals from the decisions in *Dreamvar* and *P&P Property Ltd*³, and thus we are left without a further sequel. However, the Law Society’s revised ‘Code for Completion by Post’ came into effect on 1 May 2019, paying homage to the Court of Appeal’s decision, which we consider below.

To recap, both the *Dreamvar* and *P&P* cases concerned fraudsters posing as the owners of registered properties. In both scenarios, fraudsters instructed solicitors and agents to act for them on the sales of the properties and genuine buyers were found. The buyers instructed their own solicitors, and proceeded to exchange contracts and completion in accordance with the Law Society Code for Completion by Post (2011) (‘the Code’). Following completion, but before registration of title, the fraud was discovered, but the fraudster and the purchase money had disappeared. In *P&P* the buyer brought a claim against the seller’s solicitor (and the selling agents). In *Dreamvar* the buyer brought proceedings against its own solicitor and the seller’s solicitor.

In summary, the Court of Appeal decided the following in relation to the solicitors’ liabilities:

Negligence

The seller’s solicitor owed no duty in negligence to the buyer. This was despite the solicitor’s failure to adequately check its client’s identity, which could have alerted the parties to the fraudster.



The general rule that a solicitor does not owe a duty to anyone but its client was preserved. This was not an exception circumstance where instructions had been received to benefit both the client and a third party.

Breach of Warranty of Authority

Requiring 13 pages of judgment, the Court of Appeal confirmed that a seller’s solicitor may give an implied warranty that it is authorised to act on behalf of the actual owner. LJ Patten came to this conclusion “...on an implication based on all the relevant circumstances...” considering the “proper context”, that the seller’s solicitor in *P&P* represented that she signed and exchanged contracts on behalf of the person who was named in the document as the “Seller”, but who was in fact the innocent owner.

This finding has potentially far-reaching implications on the profession. In any transaction where a solicitor is signing contracts or pleadings on behalf of its client, the solicitor may be said to be warranting that it acts for the actual named person in the documents. If the client is, in fact, a fraudster the *Dreamvar* breach of warranty argument may be pleaded.

¹ “The Hazards of Handling Client Money” at <https://www.marsh.com/uk/insights/research/client-adviser-the-hazards-of-handling-client-money.html>.

² “Nightmare on Any Street Dreamvar Part 2” at <https://www.marsh.com/uk/insights/research/dreamvar-insurance-and-risk-management-implications.html>.

³ *P&P Property Ltd v Owen White & Catlin LLP and another*; *Dreamvar (UK) Ltd v Mischon de Reya and others* [2018] EWCA Civ 1082.

L J Patten spent only four paragraphs of the judgment confirming that (i) reliance on the warranty was required by law, and (ii) such reliance had not been evidenced in the particular claim. Thus, the seller's solicitor was not in breach.

L J Patten did not explain what would be enough to demonstrate reliance, only that an expectation that the seller's solicitor would properly carry out client identity checks was insufficient. As a result, there is no assistance in understanding what constitutes sufficient evidence of reliance in this particular situation. Possibly an internal file note would be adequate, but perhaps more positive action is required, such as the buyer's solicitor setting out its reliance in open correspondence with the seller's solicitor. In relation to the latter, a potential conflict situation could arise for the seller's solicitor i.e. if a seller's solicitor wishes to refute the warranty that it is acting for a genuine seller, then its own client's position could be prejudiced. To avoid such own interest situations, it would be sensible for the seller's solicitor to raise these issues with the client at the outset when the retainer is agreed.

Breach of Trust

In the first instance decision of *Dreamvar*⁴, the court determined that it was implied into the retainer with the buyer's solicitors that the solicitors were only authorised to release the purchase monies upon completion of a genuine sale. This was not appealed.

However, the Court of Appeal was asked to determine whether the seller's solicitors were also in breach of trust. The court found that they were in breach of trust on grounds that under the Code the seller's solicitors, on completion, act as agent for the buyer. The court held that in paragraph 10 of the Code the word "*completion*" must mean genuine completion of a genuine sale of the relevant property. As completion did not take place, the seller's solicitor had no authority to release the money to their clients or otherwise dispose of it in accordance with their instructions. To some this interpretation it is not a surprise as it is in line with the interpretation in *Markandan*⁵.

Section 61

What is perhaps the most controversial part of the *Dreamvar* decision is the court's refusal to relieve the buyer's solicitors for the breach of trust. Section 61 of the Trustee Act 1925 provides that "*If it appears to the court that a trustee... is or may be personally liable for any breach of trust... but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust... then the court may relieve him either wholly or partly from personal liability for the same*"⁶.

L J Patten considered that the first instance court was entitled to have regard to the "*disastrous*" consequences of the breach

of trust by the buyer's solicitors on *Dreamvar*, including the fact that *Dreamvar* had no insurance against fraud, was small and was left with creditors of more than £1.2million, whereas the buyer's solicitors had insurance.

Nevertheless, it is clear that insurance was not the only factor that contributed to the buyer's solicitor's failure to obtain relief. The court highlighted that it would have made the same decision even if the buyer's solicitors did not have insurance as "*with or without insurance*" they were "*far better able to meet or absorb the loss than Dreamvar*". Additionally, it was noted that the buyer's solicitors were far better placed to consider, and as far as possible achieve, greater protection for *Dreamvar* against the risk that, in fact, materialised. Thus, the buyer's solicitors failed to prove that it was "*fair*" to grant relief.

While the innocent buyer's solicitors had been held liable in breach of trust and refused relief, the Court of Appeal confirmed that they could seek contribution from the seller's solicitors (who did not have this option).

Additionally, as the Court of Appeal specifically noted, the retainer letter of the buyer's solicitors did not expressly deal with the terms on which the buyer's solicitors would hold and be authorised to release the purchase monies to the buyer or his solicitors. Thus, the first instance judge implied a term into the retainer letter that had the effect of creating a duty. It is arguably open to solicitors acting for a buyer in a red-flag situation to specify in their retainer that that they are entitled to release purchase monies to a genuine firm of solicitors; consequently, avoiding a claim for breach of trust in similar circumstances. In order for the express term to be upheld by the court we think it is likely that the solicitor will need to fully explain the red flags which have been identified, the risk of loss associated to the red flags, and the implications of the express term to the client i.e. that if the seller turns out to be a fraudster that the client will only have a claim against the seller's solicitors.

Breach of Undertaking

In both *P&P* and *Dreamvar* exchange of contracts and completion proceeded in accordance with the Code.

The Court of Appeal confirmed that the seller's solicitors were in breach of undertaking to the buyer's solicitors implied by the 2011 Code. Under paragraph 7 (i) of the Code, the seller's solicitor expressly undertakes "*to have the seller's authority to receive the purchase money on completion...*" The court determined, despite there being no definition of 'Seller', that on a "*true construction of the Code*" the sellers' solicitor had given undertakings that it had the authority of the real owners to receive the purchase monies on completion.

⁴ *Dreamvar (UK) Ltd v Mishcon de Reya* [2016] EWHC 3316, para 91.

⁵ *Lloyds TSB Bank v Markandan & Uddin* [2012] EWCA Civ 65.

⁶ *P&P Property Ltd v Owen White & Catlin LLP and another; Dreamvar (UK) Ltd v Mishcon de Reya and others* [2018] EWCA Civ 1082, para 103.

This interpretation of the Code produces a strict liability for blameless solicitors acting on behalf of ‘Sellers’. The effect is that claims against such solicitors are made simple for innocent buyers who have lost their money. Additionally, there is no need for the innocent buyer to make a complicated claim for breach of warranty that could fail on the grounds of lack of reliance (as in *Dreamvar*).

Changes made to the Law Society Code for Completion by Post

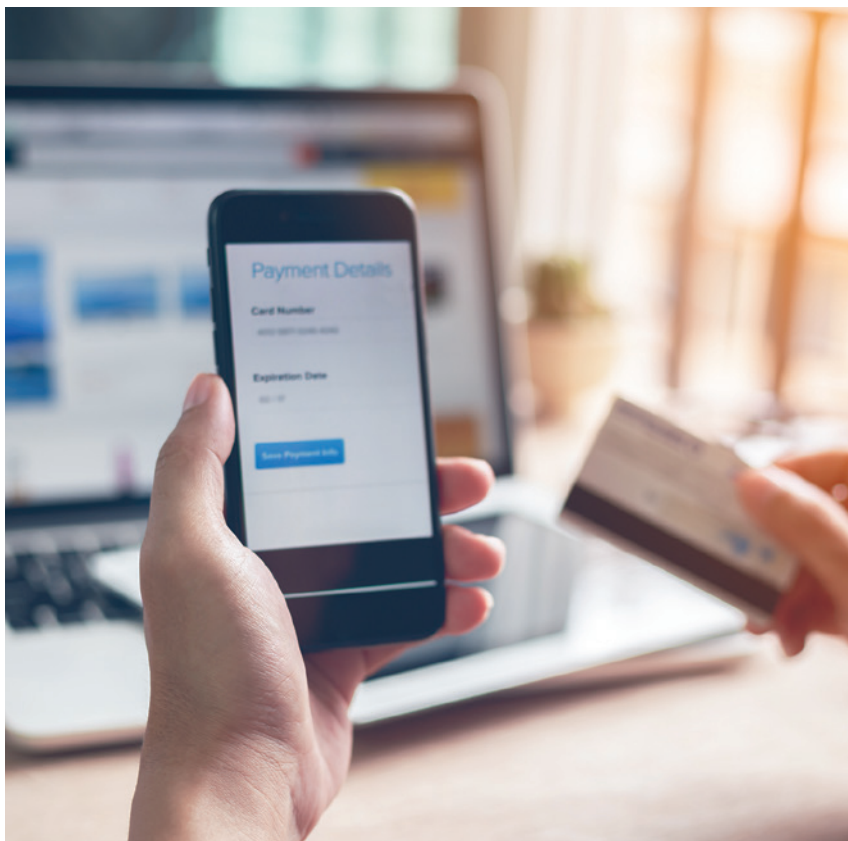
The Law Society previously intervened in the *Dreamvar* appeal, seeking an outcome that apportioned liability according to fault. Therefore, post the Court of Appeal’s decision, it was entirely plausible that the Law Society could have rebutted the court’s interpretation by revising the Code to limit liability for blameless solicitors, especially in circumstances where the seller’s solicitors had completed enhanced due diligence and still been duped by a sophisticated fraudster.

This did not happen.

The Law Society’s amendments were designed to reflect the current case law. Thus, the amended Code explicitly confirms that:

- (i) A ‘Seller’ is “*the person...who will be at the point of completion entitled to convey the legal and/or equitable title to the property*” (para 2 (i)).
- (ii) The seller’s solicitor holds any purchase money on trust for the person who provided it and is under a fiduciary duty not to deal with that money other than in accordance with the Code (para 4 (ii)).
- (iii) Para 8 (i) of the Code constitutes an undertaking by seller’s solicitor that it has authority from the “*true*” owner of the property named in the contract to receive the purchase money and convey title (sixth note).

Thus, the revised Code makes it clear that the seller’s solicitor must be acting in a genuine sale. The Code seeks to provide innocent purchasers with greater protection from fraudsters, to the detriment of potentially blameless solicitors.



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Risk Management Steps

Aside from the legal implications, there are risk management considerations that arise across both firms and individual practice areas. The profession and its clients remain exposed to this type of identity fraud in many ways. We continue to suggest the following actions:

Level	Threat Area	Risk Controls/Response
Firm-wide	Standard risk processes may not be sufficient for high-risk retainers (for example high-value areas known to be targeted by identity fraudsters).	Across all practice areas, higher risk matters need to be identified and managed appropriately. Risk controls need to be reviewed against current threats to see if they are adequate to meet the increased threat. Additional checks as to identity and supporting documentation may be required.
	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.	A high level of vigilance and checking is justified, and AML and other identity processes need be undertaken with vigour. Increased checking for higher risk retainers must be completed to a high standard. Reminders and training to raise awareness about latest trends can help reduce the risk of becoming a victim of crime.
	Authority and identity of clients may be false or assumed.	Given the Court's approach, firms should warn fee earners of the risk of unintentionally creating warranties as to the identity of the clients. Template letters should be reviewed and firms should consider inserting language confirming that no warranty as to identity is given. Solicitors will need to agree these future warranties with their client at the start of the retainer (so as to avoid an own-interest conflict). When possible, the client should sign final versions of contracts, pleadings and so on.
	Undertakings enable transfer of significant client funds and so create opportunities for fraudsters. Significant loss can emerge if the terms of the undertaking, or the PI insurance of the firm proves inadequate.	Controls should be implemented: <ul style="list-style-type: none"> • Who can give or accept undertakings. • Up to what level? Consider additional sign-offs as the value increases. • How is the drafting reviewed? All the above needs to be regularly updated and monitored.
Conveyancing departments	Most transactions are straightforward house moves involving a mortgage, estate agents, a chain, and known clients. Risks are significantly increased where high value and equity are involved. Such transactions need to be identifiable so that additional risk measures can be applied and monitored consistently.	Where there are red flags, warnings should be given and additional due diligence undertaken. Red flags include: <ul style="list-style-type: none"> • Unmortgaged property. • Property not occupied by the seller. • Swift sale required. • Value of property is unusually low without a plausible and verified reason. • Client is willing to drop the sale price quickly. • Property not on the market long. • Overseas seller and buyer. • No chain. • No agents. • Records from previous purchase not provided/unavailable. • Limited contact details, for example telephone and/or email address. • The client is reluctant to answer questions from the solicitor or from the buyer.

Level	Threat Area	Risk Controls/Response
		<p>For sellers' solicitors:</p> <ul style="list-style-type: none"> • Increased due diligence on clients to establish identity, including: <ul style="list-style-type: none"> - Electronic identity checks. - Obtaining records from the purchase of the property now being sold. - Reviewing AML documents originally supplied for purchase file. - Requesting documentation that you might expect an owner of a property to have, even if they do not live in it, for example insurance for the property, invoices for repairs? - Meeting the seller in person. • Review how to prevent warranties as to identity being given: <ul style="list-style-type: none"> - Standard wordings exclusions/limitations, for example potentially disclaiming any warranty of authority but instead undertaking an express assumption of responsibility to the buyer to exercise reasonable care in checking the seller's identity. Solicitors will need to agree these future warranties with their client at the start of the retainer (so as to avoid an own interest conflict). - Warnings/reminders to fee earners.
		<p>For buyers' solicitors (for suitable cases):</p> <ul style="list-style-type: none"> • Ensuring that the retainer letter specifies that the solicitor is entitled to release purchase monies to a genuine firm of solicitors and explaining the potential implications to the client. • Prior office copy search results and other randomised verifying information from the seller from their property purchase transaction could be requested, as a genuine seller would be expected to possess these or be able to produce them. • Ensuring that the retainer letter has a liability cap, which is drawn to the client's attention. • Warnings to clients that the property has high-risk features, and proceeding could have the result that all the money is lost. If the subject matter is complicated, warnings should be clear and unambiguous (as they might be harder to rely on). Consider also advising the client to take independent advice. • If the sale continues, ensuring there is written evidence that demonstrates that the solicitor had informed consent to proceed from the client. • Advising the client of insurance options available. • Confirming to the seller's solicitor that they are relying on the seller's solicitor's warranty of authority. • Advising their client against agreeing any variations to the Code, which the seller's solicitors may wish to introduce.

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