



# Dreamvar and identity fraud in conveyancing transactions

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May 2018

**The issue at stake in the combined appeals of *Dreamvar (UK) Ltd v Mishcon de Reya* and *P&P Property Ltd v Owen Catlin LLP* (Court of Appeal, 15 May 2018) was a fairly fundamental one, namely: “Who ought to bear the risk of loss when a fraudster pretends to sell a property?”**

The Court of Appeal’s answer, in a nutshell, is that the loss should be shared across the solicitors for the buyer and seller. Of course, any answer that fits inside in a nutshell is insufficient to do justice to the complexities of this important decision. It is a case that is likely to have profound implications for the mechanics of conveyancing and solicitors’ professional indemnity insurance.

## The facts

To understand those implications, one must start with the facts. These can be simplified for current purposes as follows: in both cases fraudsters pretended to be the sellers of properties, their fake identities deceived their respective solicitors, the buyers paid over the purchase monies and the ‘sellers’ and the monies vanished, never to be seen again. Unsurprisingly, the buyers then cast around for an insured professional to sue. The targets of the litigation were the buyer’s solicitors, the seller’s solicitors and the estate agent.

## Why the litigation?

Before getting on to the legal analysis it is worth considering why these cases ended up being disputed at all rather than settled. There appear to be two root causes. The first concerned the information asymmetry present in conveyancing. A buyer naturally expects his or her solicitor to be able to provide reassurance that the seller is the genuine owner of the property; however, the buyer’s solicitor is not usually in a position to check the identity of the seller (who is, after all, not his client...). Meanwhile, the seller’s solicitor is in a position to undertake identity checks on his client, and indeed is compelled to do so under anti-money laundering legislation (here, the Money Laundering Regulations 2007, now replaced by Money Laundering Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017), but the seller’s solicitor may be unwilling to share those checks with the buyer or warrant that they are accurate.

## Any comments or queries?

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The second root cause of the dispute concerned lingering uncertainty over the precise meaning of aspects of the contractual machinery governing the purchase of property. That machinery has evolved over the years so as to allocate in a reasonably predictable manner the various risks arising in conveyancing. It is perhaps surprising that it should still be capable of differing interpretation when it comes to something as commonplace as identity fraud.

### Legal arguments

The buyers argued for four pathways to liability (although not all were engaged in both cases). These were:

- negligence by the seller's solicitors when carrying out client due diligence
- breach of warranty of authority by the seller's solicitors
- breach of undertaking by the seller's solicitors
- breach of trust by the seller's solicitors and the buyer's solicitors when paying out the funds (and relief from breach of trust).

### Negligence

The negligence argument involved the buyers saying that the sellers' solicitors owed them duties of care when carrying out identity checks on their clients (and of course the allegation that those checks were sub-standard). Unsurprisingly, the buyers failed on this point. The long-established rule is that a solicitor acting for a seller does not owe a duty of care to the would-be buyer when answering pre-contractual inquiries (see *Gran Gelato Ltd v Richcliff (Group)* [1992] Ch 560). In *Dreamvar* and *P&P*, the Court of Appeal could find no reason to dislodge this normal rule in circumstances where a seller's solicitor carries out identity checks on his client. There are two key aspects to the Court's reasoning. The first is that the buyer's argument would have imposed on solicitors a common-law duty of care to buyers when carrying out

statutorily-mandated due diligence checks in circumstances where that same framework did not create a statutory duty which if breached gave rise to a cause of action at the suit of the buyers (at paragraphs 72, 78 and 81). The second part of the reasoning was that the sellers' solicitors were not asked to give undertakings or assurances as to the adequacy of their due diligence and in its absence they could not be said to have voluntarily assumed responsibility to the buyers (at 81).

### Breach of warranty of authority

Breach of warranty of authority is the most complex of the points raised in *Dreamvar* and *P&P*. It arises as follows: a solicitor is an agent of her principal when acting on a conveyancing transaction; an agent is taken to represent to a third party that she has authority to act on behalf of the principal; if the agent lacks such authority, and the third party relies on that representation and incurs loss, then the agent will be strictly liable for it in contract. As the agent's liability to the third party is in contract it therefore follows that the nature and effect of any representation is to be interpreted in accordance with conventional contractual principles (ie what an informed and objective bystander with all the relevant background information available to the parties would have understood the representation to mean). In *Dreamvar* and *P&P* the issue of authority turned narrowly on the meaning to be assigned to words in the contractual language used in conveyancing. Specifically, when a solicitor says she is authorised to enter into a contract by "the vendor", does that mean she is acting for the client she has, or for the person the client purports to be?

The key part of the Court of Appeal's reasoning is that the buyer intends – via the objective language of the contract – to deal only with the person whose name and identity appears on the contract, and not with the

actual individual (the fraudster) with whom the sale has been negotiated and agreed. This was Lord Justice Patten's answer to the point raised by the sellers' solicitors to the effect that they did not want to warrant the identity of their clients: by executing and exchanging contracts on behalf of the client they were taken to have "...adopted the terminology of the contract to describe the person she was acting for" (at 54-55).

There are some caveats needed here. The first is that the conclusion of Lord Justice Patten was manifestly fact-sensitive: it depended "...on an implication based on all the relevant circumstances" (paragraph 56). For the sellers' solicitors, a key circumstance was the signature on the contract expressed to be "on behalf of the seller". A similar conclusion was not reached upon the Court's careful analysis of the wording of the memorandum of sale prepared by the estate agent (at 57). The second caveat is that the Court of Appeal held that reliance on the representation was an essential feature of the cause of action (at 59). This opens the door for solicitors to argue in a given case that there was no such reliance eg by showing that the buyer merely relied on an expectation that the seller's solicitor would properly carry out client identity checks.

### Breach of trust and breach of undertaking

One of the key roles of a solicitor acting on a conveyancing transaction is to hold the monies on bare trust to the order of his or her client. The entitlement of the solicitor to part with that money is determined by the client's instructions. In *Dreamvar* at first instance (paragraph 91, *Dreamvar (UK) Ltd v Mishcon de Reya* [2016] EWHC 3316), the court held that it was implied into the terms of the buyer's solicitors' retainer that they were only authorised to release the purchase monies upon completion of a genuine sale (at 86). This was not challenged on appeal.

The more important aspect of the Court of Appeal's decision in *Dreamvar* and *P&P* is that **the seller's solicitors** were also held to be in breach of trust on grounds that under the Law Society Code for Completion by Post (2011) ("the Code") the seller's solicitors, on completion, are taken to act as agent for the buyer for the purposes of complying with that Code, and paragraphs 10 and 11 of the Code, on their proper interpretation, require the seller's solicitors only to release the funds to the seller where there has been a genuine completion of the relevant property (at 88, 97).

As for the breach of undertaking case, the buyers succeeded in their argument that paragraph 7 of the Code, where it makes provision for the seller's solicitor to undertake "to have the seller's authority to receive the purchase money on completion", on its proper interpretation meant authority to complete on behalf of the real owner and not the fraudster.

### Relief from breach of trust

The most alarming aspect of the first instance decision in *Dreamvar* concerned the application of section 61 of the Trustee Act 1925. This section allows the court to relieve a trustee from part or all of his breach of trust provided he has "acted honestly and reasonably, and ought fairly to be excused for the breach of trust". Section 61 has long been seen as a counterweight to the strictness of a trustee's liability for breach of trust especially where (as with *Mishcon de Reya*) the trustee has otherwise acted impeccably and without negligence.

There was no such counterweighting here: Lord Justice Patten described as "unimpeachable" the judge's decision that it was unfair to relieve the buyer's solicitors from their breach of trust because they were insured for the loss whereas *Dreamvar* was a small company with no such insurance. Interestingly, Lady Justice Gloster disagreed

with the majority decision in this regard. She considered that the Court's assessment of fairness for the purposes of s. 61 should not be affected by the (non)-existence of insurance (at 125).

### Implications, generally

The *Dreamvar* and *P&P* decision is something of a mixed bag for conveyancers and their insurers. On the positive side, the Court found that the normal machinery of conveyancing involves the seller's solicitors in effect giving a promise to the buyer that they acted for the genuine seller. Given that the seller's solicitors are in the best position to check the identity of their client this seems both a sensible and fair outcome. It places the risk on the person best placed to shoulder and mitigate it. On the negative side, the imposition of strict trust obligations, and the lack of relief from breach of trust, for buyer's solicitors, is more problematic. It seems fundamentally wrong that s. 61 relief should be affected by the existence of insurance cover. It means that an insured professional acting as trustee may rarely, if ever, be able to take advantage of s. 61, unless he or she can show that the beneficiary-client is insured as well. Furthermore, this is an argument we can expect to see raised in contexts other than conveyancing.

### Implications for defending claims against solicitors

Following *Dreamvar* and *P&P*, the main message for solicitors and their insurers is that buyers who incur losses as a result of conveyancing identity fraud are now considerably more likely to be able to pass on those losses to one or more of the firms of solicitors involved. The buyer's remedy will be at its most effective and simplest if it can be formulated as a breach of trust claim. Unless the buyer is also insured, s. 61 defences look unhelpful. The breach of trust claim may be very difficult to defend, given that its main elements are proof that the solicitor held

the funds on instructions only to pay away in respect of a genuine sale.

We therefore expect to see the litigation battleground shift to the contribution claim between the two sets of solicitors. It is in that context that issues such as respective fault (in conveyancing practice and in the quality of client due diligence) may well determine the apportionment of loss and therefore which firm of solicitors' insurers will pick up the financial consequences.

### Risk management implications

There are many risk management lessons to be learned from *Dreamvar* and *P&P*. We have provided a selection below.

The first risk mitigant is to take steps, where possible, to avoid *Mishcon de Reya's* fate by negating the implication that the buyer's monies are held on trust by the buyer's solicitors for payment in respect of a genuine sale. Express words in the retainer could help here but they may be difficult to sell to clients and they must be included at the start of the retainer – a solicitor could easily get into an own interest conflict if he or she attempts to introduce them mid-retainer.

A second safeguard is for the buyer's solicitors to seek some sort of confirmation, warranty or comfort from the seller's solicitors concerning the adequacy of their client due diligence (in order to support the imposition of a duty of care in favour of the buyer). Sellers' solicitors will of course resist such requests but the manner in which they resist, and any continuing reluctance to cooperate, could be warning flags that there is something odd going on.

We also anticipate attempts to tinker with the contractual machinery eg for sellers' solicitors to try to avoid warranting authority on behalf of the genuine seller or to tweak the Code so as to avoid breach of trust claims. The

buyer's solicitors will need to watch out for such attempts and resist them. It is possible that some form of compromise could be reached whereby sellers' solicitors are allowed to remove the usual warranty of authority provided they share their client due diligence checks with the buyer.

There is, however, a fundamental problem with modifying the contractual machinery in this manner. Such modifications involve the respective solicitors taking steps to preserve their own interests in some situations, potentially at the expense of their client's best interests. For example, if a seller's solicitor wants to negate the usual warranty of authority that he or she is acting for a genuine seller, then the only person to benefit from that step is the solicitor: the seller has no proper interest in a clause that (by definition) only applies if the seller is a fraudster. If such steps are not to result in own interest

conflicts then they may need to be raised with the client at the stage when the retainer is being negotiated.

In the medium to longer term the conveyancing market itself may change. The Law Society might be amenable to modifying the Code but that will doubtless only occur after extensive and time-consuming consultation and debate. Identity verification services might step into the breach and offer reliable means whereby buyers can feel comfortable that they are dealing with a genuine seller (but then the buyer's solicitor will need to be satisfied that the service is a reliable one...). It is also possible that an insurer may develop a buyer's identity fraud insurance product, thereby allowing the solicitors to de-risk, but we doubt that the premiums for such a product will be appealing unless it attracts a wide level of acceptance.