The Dreamvar Appeal: Material changes to the exposure of solicitors caught up in fraudulent property transactions

Conveyancers and their Insurers will note material changes to their claim exposures following this week’s Court of Appeal decision writes Stephen Reilly, Partner, and Lisa Henty, Associate. The Appeal decision means that the seller’s solicitors, as well as the buyer’s solicitors, are now squarely exposed to liability in the case of an impostor property seller.

Facts

The facts in the two conjoined cases on appeal\(^1\) were broadly similar. In each case (i) the buyer was genuine and instructed solicitors to buy a residential property (ii) a fraudster purported to be the genuine owner/seller and instructed solicitors to handle the sale (iii) at completion, the buyer’s solicitors forwarded the completion monies to the seller’s solicitors who (unwittingly) forwarded those monies to the fraudster seller and (iv) the fraudster disappeared with the monies and could not be traced.

Court of Appeal decision

The Court of Appeal reversed the High Court on several key issues:

**Breach of warranty of authority by the Seller’s solicitor.** An agent who represents to a third party that he has authority to act on behalf of someone else is treated as warranting that he has such authority and is liable for any loss caused to the third party in reliance on the representation. The High Court found that when the seller’s solicitor had represented that they acted for the “Seller” they were representing that they acted for the man who purported to be the seller i.e. the fraudster. They did not warrant that they acted for the true owner of the property and so were not in breach of warranty of authority. The Court of Appeal spent considerable effort in its judgment traversing the law in this area and reversed the High Court decision finding that when the seller’s solicitor signed the Sale Contract on behalf of the seller (on the specific facts) she was warranting that she acted for the true owner of the property, not the fraudster. She was therefore in breach of warranty.

\(^1\) [2018] EWCA Civ 1082 (15 May 2018)
However, the buyer’s solicitor had given witness evidence that he had not relied on this warranty and so no liability was found.

**Breach of duty.** The Court of Appeal upheld the High Court’s decision (based on a long line of cases) that the seller’s solicitor does not owe a duty of care to the purchaser to competently carry out its Money Laundering (identity) checks, to ascertain the identity of its seller client or to ensure its client’s proposed transaction was a genuine one. An assumption of responsibility could potentially arise depending on the facts but here where the buyer had their own solicitors it would not be fair to impose such a duty.

**Breach of Undertaking.** Again the Court of Appeal reversed the High Court finding. The Law Society Code for Completion by Post 2011 (“the Code”) applied to each property transaction. Paragraph 7 of the Code states that “the seller’s solicitor undertakes (i) to have the seller’s authority to receive the purchase money on completion…BUT if the seller’s solicitor does not have all the necessary authorities then…not to complete without the buyer’s solicitors instruction”. Similar to the breach of warranty of authority issue, the question was whether the seller’s solicitor had undertaken that he had the authority of (i) the fraudster or (ii) the genuine registered owner. The High Court held the former, finding the seller’s solicitor was not in breach of Undertaking. The Court of Appeal reversed and held that on a proper interpretation of the Code, the seller’s solicitor was in breach of Undertaking - “The only person who could give that authority for the purposes of the completion of a genuine sale would be the true owner of the property”.

**Breach of Trust.** It was (broadly) common ground that the purchase monies were held on a bare trust for the Buyer by, first, the buyer’s solicitors and, later, the seller’s solicitors, as the monies passed from one to the other pending completion (see Target Holdings Ltd v Redfem). In the High Court (i) the buyer’s solicitors in Dreamvar had conceded that they were in breach of trust for releasing the purchase monies but failing to obtain good title to the property for their client – this point was not appealed - and (ii) the Court had found that the seller’s solicitors were not in breach of trust for releasing the purchases monies to their fraudster client. The reasoning for that was found at paragraph 3 of the Code “…In complying with the terms of the code, the seller’s solicitor acts on completion as the buyer’s solicitor’s agent without fee or disbursement but this obligation does not require the seller’s solicitor to investigate or take responsibility for any breach of the seller’s contractual obligations …”

The High Court found that “…If the [seller’s] solicitor is liable for breach of trust merely because no genuine transfer is provided it would effectively be taking responsibility for what paragraph 3 says it is not.”

The Court of Appeal reviewed the Code and the relevant law and reversed this decision finding in each case the seller’s solicitors to be in breach of trust – paragraph 3 of the Code did not excuse liability for breach of trust, it only absolved the seller’s solicitor from any responsibility to the buyer as his agent to investigate possible contractual breaches by the seller.

**Section 61 Trustee Act 1925.** Per s.61 the Court can relieve a trustee for breach of trust if (i) they have acted honestly and reasonably and (ii) they ought fairly to be excused for the breach. This is the issue that had generated so much press following the High Court ruling where Mischon De Reya (MDR) - the buyer’s solicitor in the Dreamvar case - were complaining that the High Court had failed to grant them relief where they had acted non-negligently and honestly. The High Court’s reasoning was that (i) the buyer Dreamvar had no separate recourse against the seller’s solicitors (ii) while MDR had not acted negligently, it was better placed than its buyer client to protect against a possible fraudulent transaction and (iii) MDR had the benefit of insurance.

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The Court of Appeal, despite reversing the High Court on the seller’s solicitors exposure to the buyer Dreamvar, upheld (on a majority 2:1) the High Court’s decision on s.61 relief as regards MDR, calling the High Court’s reasoning “unimpeachable”. While MDR remains liable to its buyer client for breach of trust, it can however now seek contribution from the seller’s solicitors on a Civil Liability (Contribution) Act claim basis.

Commentary

As regards each specific legal issue considered, the Court of Appeal stressed the importance of considering the very specific facts of each transaction before reaching a conclusion on the legal position. Case outcomes will potentially differ depending on (i) the terms of the solicitor’s client retainer (ii) the contractual promises made between the parties and their solicitors and (iii) the conveyancing Code used/agreed mechanics of the conveyance in issue. However, where current standard contractual documentation/completion codes/retainers are used, the Court of Appeal’s decision makes important changes to the seller’s solicitors’ exposure to the innocent purchaser.

Conveyancing solicitors should note the Court’s findings and (i) tighten up their client due diligence processes – a common theme of the cases reaching Court is a failure on the seller’s solicitor’s part to follow Money Laundering /Law Society guidance and properly vet the identity of their client and (ii) consider carefully the Undertakings and contractual promises made through the conveyancing process. The former is relatively easy. The latter is more difficult and we will see whether the efficiency of the conveyancing process is now encumbered by both seller and buyer side solicitors heeding this Judgment and seeking to contractually pass the risk of a fraudulent transaction to the other.

Based on current standard conveyancing retainers, processes and contractual documentation, both sets of solicitors are now the effective guarantors that the seller is genuine and will have to meet the buyer’s losses where the seller turns out to be a fraudster.

We await to see if an appeal is made to the Supreme Court.

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