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Professional Negligence Briefing

Protecting Buyers from Identity Fraud

Introduction

Who bears the loss if you buy property but then find out that you have dealt with a fraudster? In three recent cases the courts have found that the seller's solicitor, the buyer's solicitor and the buyer themselves could be the party that suffers the ultimate loss.

Not surprisingly, buyers' solicitors are anxious to protect their clients from the risks of identity fraud. This article suggests five ways that those acting for buyers can protect their clients (and themselves) from the risk that the seller is a fraudster.

The Three Cases

In the first case, *Purrusing v A'Court & Co [2016] EWHC 789 (Ch)*, the claimant brought a claim for breach of trust against his registered conveyancer (who admitted the breach) and the solicitor who acted for the fraudster (against whom summary judgment was granted). Both defendants applied for relief under section 61 of the Trustee Act 1925. Relief was refused to the seller's solicitor because he had not complied with his duty under the Money Laundering Regulations 2007. Relief was also refused to the buyer's conveyancer because he had failed to advise the claimant properly about an unsatisfactory response given to an enquiry in the following terms:

"Please confirm you are familiar with the sellers and will verify they are the sellers and check ID to support same."

In the second case, *P&P Property Ltd v Owen White and Catlin LLP [2016] EWHC 2276 (Ch)*, claims against the solicitors and the estate agents that had both acted for the fraudster failed. The defendants did not owe the claimant any duty of care, had not held the purchase monies on trust and had not warranted that their client was the true owner of the property.

The final case is *Dreamvar (UK) Ltd v Mischcon de Reya [2016] EWHC 3316 (Ch)*. As in P&P the claim against the seller's solicitor failed but the buyer's claim against its own solicitor for breach of trust succeeded and the judge refused the solicitor's application for relief under section 61 of the Trustee Act 1925. Although the buyer's solicitors had not been negligent, they had not advised about the risk of identity fraud or sought an undertaking from the seller's solicitor that it had taken reasonable steps to establish the seller's identity. The judge held the buyer's solicitor was better placed than the buyer to achieve greater protection against the risk of identity fraud and so ought not be excused for the breach of trust.

Permission to appeal to the Court of Appeal has been granted in P&P and Dreamvar.

Five Ways to Protect the Buyer

1. Prompt Registration

A simple step is to ensure prompt registration of the transaction with the Land Registry.

In P&P there was a delay of around 3 weeks before an application was made to register the sale. The fraud came to light before registration was completed and the true owner was able to apply for a restriction to prevent the transfer being registered.

Had P&P's registration been completed it would have enjoyed statutory protection of its title under the Land Registration Act 2002. A registered proprietor's title can only be rectified without his consent if either (a) he has by fraud or lack of proper care caused or substantially contributed to the mistake, or (b) it would for any other reason be unjust for the alteration not to be made (LRA 2002 Sch 4 para 3(2) and 6

(2)). If the buyer's title is rectified it will still be entitled to be indemnified by the registrar for the loss suffered by reason of the rectification (LRA 2002 Sch 8 para 1) so long as the loss was not caused wholly or partly by its own fraud or wholly by its own lack of proper care (LRA 2002 Sch 8 para 5(1)).

Whilst prompt registration can protect the buyer, if an indemnity is awarded it might not be the end of the matter for the buyer's solicitor. The registrar has a statutory right of recourse to "any right of action (of whatever nature and however arising)" to recover the amount paid as an indemnity from third parties (see LRA 2002 Sch 8 para 10). Solicitors can take some comfort from the fact that, in accordance with assurances given to Parliament during debates leading to the passing of the 2002 Act, the registrar will only pursue the right of recourse if the solicitor was negligent or fraudulent.

2. Trust of Purchase Monies

It is well-recognised that a solicitor who receives money from a lender for the purpose of completion ordinarily holds the mortgage advance on trust and commits a breach of trust if they part with the money otherwise than upon a valid completion. If there is a breach of trust but the solicitor acted honestly and reasonably the court has a discretion under section 61 of the Trustee Act 1925 to relieve the solicitor either wholly or partly from personal liability (see e.g. *Davisons (Solicitors) v Nationwide [2012] EWCA Civ1626* and *Lloyds TSB Plc v Markandan [2012] EWCA Civ 65*).

These principles were applied in *Purrusing* where the lawyers on both sides of the transaction were liable for breach of trust and were not granted relief under section 61.

In *P&P* and *Dreamvar* the buyers argued that the purchase monies sent to the seller's solicitors were subject to a trust that was breached. The sales in *P&P* and *Dreamvar* proceeded under the 2011 edition of Law Society Code for Completion by Post. The seller's solicitors would have held the purchase monies on trust if the parties had used the 1998 edition of the Law Society Code for Completion by Post (as in *Purrusing*). The judges in *P&P* and *Dreamvar* both decided that under the 2011 edition of the Code the position is different: the seller's solicitor does not hold completion money on trust unless either expressly notified by the buyer's solicitors that it holds the funds to the buyer's solicitor's order or the parties agree that completion is to take place at a later date.

Whilst use of the 2011 edition of the Code can prevent the seller's solicitor from assuming duties as a trustee it does not relieve the buyer's solicitor of its obligation as a trustee. In *Dreamvar* the buyer's solicitor held the completion monies on trust and could only release the purchase monies on completion of a genuine completion.

The lesson for buyer's solicitors therefore is to insist that purchase monies transferred to the seller's solicitor are held to the order of the buyer's solicitor. This can be done by using the 1998 edition of the Code (which contains an express terms to this effect in para 6) or by giving a notification to the seller's solicitor that funds are to be held to the buyer's solicitor's order (see para 10(i) of the 2011 edition of the Code, para 218 in *P&P*, and para 103 in *Dreamvar*).

A problem with this solution is that some solicitors accredited to the Law Society's Conveyancing Quality Scheme (CQS) consider that they are unable to give or accept a notification that funds are to be held to the buyer's solicitor's order. The rules of the CQS require compliance with the Law Society Conveyancing Protocol which in the case of completion by post requires the solicitor to, "*comply with the Law Society Code for Completion by Post without variation unless instructions are given by the seller and are specific to the needs of the individual transaction*" [emphasis added].

There is a strong argument that giving a notification to the seller's solicitor that funds are to be held to the order of the buyer's solicitor does not constitute a "variation" but is permitted by the 2011 Code as

it is provided for under paragraph 10(i). When contacted about this issue for this article the Law Society responded that:

“The Conveyancing and Land Law Committee which has ultimate responsibility for CQS are aware of the issue and the committee has put together a working group to review the both the code and the related documents in the light of recent decisions. However it is not possible to say at this stage how long such a review might take.”

3. Pre-Contract Enquiries

An increased awareness of the risk of identity fraud has led to buyer’s solicitors making pre-contract enquiries about the steps taken to verify the seller’s identity.

The first reason to make such an enquiry is that it should cause the seller’s solicitor to reflect on what they know about their client, whether they have complied with their money laundering duties and to share some information with the buyer’s solicitor.

A second reason to make such an enquiry is to support an argument that the seller’s solicitor owes a duty of care to the buyer. In *P&P* the claimant failed to establish that there was a duty of care owed to buyer by the seller’s solicitor because there had been no communication between the buyer’s solicitor and seller’s solicitor about the ascertainment of the seller’s identity. A difficulty with relying on an answer to a pre-contract enquiry to establish a duty of care is that, “in normal conveyancing transactions solicitors who are acting for a seller do not in general owe to the would-be buyer a duty of care when answering inquiries before contract or the like” (per Nicholls V-C in *Gran Gelato v Richcliff* [1992] Ch 560 at p570D). There may however be “special cases” where a duty of care will be owed (see *Gran Gelato* at p571H). Given that an enquiry about the steps taken to verify the identity of the seller concerns matters wholly within the seller’s solicitor’s knowledge, unless the answer is given subject to qualifications or with a disclaimer of responsibility, there may well be a “special case” for imposing responsibility for the answer on the seller’s solicitor.

A third reason to make an enquiry is that, provided that proper advice is given about the answer, the buyer’s solicitor should be better placed to apply for relief under section 61 of the Trustee Act 1925 if a valid completion is not achieved (cf: *Purrunsing* (no advice given about an unsatisfactory answer) and *Dreamvar* (no enquiry made)).

4. Undertakings

In *Dreamvar* the claimant argued its solicitor should have protected it from the risk of identity fraud by obtaining an undertaking from the seller’s solicitor that it had taken reasonable steps to establish the seller’s identity. The court in *Dreamvar* held that the solicitor was not negligent for failing to do this but in *P&P* the judge said that obtaining an undertaking from the seller’s solicitor might provide protection for buyers using the 2011 edition of the Code for Completion by post (see para 246). His suggestion was based on paragraphs 8 and 11 of the 2011 edition of the Code which provide that:

8. The buyer's solicitor may send the seller's solicitor instructions as to any other matters required by the buyer's solicitor which may include

- (i) documents to be examined or marked;*
- (ii) memoranda to be endorsed;*
- (iii) undertakings to be given;*
- (iv) deeds or other documents, including transfers and any relevant undertakings*

and authorities relating to rents, deposits, keys, to be sent to the buyer's solicitor following completion ...

11. When completing, the seller's solicitor undertakes: (i) to comply with any agreed completion arrangements and any reasonable instructions given under paragraph 8;

The buyer's solicitor can therefore give the seller's solicitor instructions to examine or re-examine all documents necessary to carry out client due diligence in accordance with the Money Laundering Regulations 2007 and receive an undertaking that they have done so. Another instruction that the buyer's solicitor might give the seller's solicitor is to compare the seller's signatures on the documents that they hold against any signature of the registered proprietor on documents held at the Land Registry (e.g. on a previous TR1, lease or charge).

Giving the seller's solicitor instructions will not protect against every fraud. It is unlikely that a reasonable instruction could protect the buyer from a sophisticated fraud using forged identification documents that would not arouse the suspicion of a solicitor exercising reasonable skill and care when inspecting them. However, taking a pro-active step to protect the buyer from the risk of identity fraud should improve the chances of the buyer's solicitor being granted relief under section 61 of the Trustee Act 1925 if fraud does occur.

5. Insurance

There are a number of insurance products that could protect a buyer against identity fraud, including Countrywide Legal Indemnities' Secure Conveyancing Insurance Policy (SCIP) and TitleSolv's 360° Homebuyer Legal Protection Policy. Both policies are only available to solicitors/conveyancers who are registered with the FCA on the Exempt Professional Register.

An insurance policy may not only protect the buyer from the risk that the seller is not the true owner, but can cover the risk of unknown title defects that the fraudster may not even have known about.

A further advantage of an insurance product is that, unlike a claim for breach of trust for which relief can be granted, recovery under the policy is not at risk if the solicitors involved in the transaction acted impeccably.

Would an insurance product have been available to protect the buyer in P&P? There were a number of factors that made the transaction in that case prone to identity fraud: the seller was resident abroad, the deposit was paid to the seller's solicitor as agent for the seller, there was no outstanding mortgage, and a quick sale was sought by the seller. Without knowing the full and specific details of the case, the insurers approached for the purpose of this article were unable to state categorically that cover would have been provided. They did indicate, however, that if their conditions of cover could have been met (e.g. that the requirements of the Council of Mortgage Lenders' Handbook could have been satisfied) insurance could have been provided.

If the buyer's solicitor has taken the steps suggested in this article it may be better placed to obtain relief, in which case the buyer could be worse off for having instructed a careful solicitor. Whilst an insurance product cannot stop fraud occurring it can protect a buyer from the consequences of a court deciding that its solicitor ought to be relieved of personal liability.

Conclusion

The suggestions in this article will not prevent identity fraud but will reduce the risks to buyers. They also highlight two problems with the current position.

Firstly, the party best placed to prevent identity fraud is the seller's solicitor who must verify the identity of the seller for money laundering purposes. It therefore made sense that under the 1998 Code for Completion by Post the seller's solicitor would be liable for breach of trust if its client was a fraudster. This has changed with the 2011 edition of the Code. Unless the Court of Appeal interprets the 2011 edition of the Code differently from the judges in P&P and Dreamvar or the Law Society confirms that CQS accredited solicitors can participate in transactions where the seller's solicitor holds the purchase monies on trust, victims of identity fraud may need to look beyond the seller's solicitor for redress.

The second point is that if the seller's solicitor does not hold purchase money on trust the buyer's best hope of recovery will often be a claim for breach of trust against its own solicitor. That claim is subject to an application for relief under section 61 of the Trustee Act 1925. If the buyer's solicitor has taken steps to protect its client from identity fraud it should be better placed to obtain relief, in which case the buyer could be worse off for having instructed a careful solicitor.



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