

# Frauds and Fakes

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## 1 Fraud and dishonesty

1.1 SRA: “The greatest risks posed to the public and consumers of legal services are fraud and dishonesty.”

1.2 SRA’s Scam Alerts

- Is there a genuine firm or person
- Identity theft and capacity certification

## 2 Mortgage fraud – some figures

2.1 Experian – attempts at mortgage fraud rose to 32 in every 10,000 applications in 2010

2.2 National Fraud Authority – mortgage fraud costs around £1 billion a year (2010)

2.3 Land Registry – anti-fraud scheme has stopped attempted fraud against properties valued at around £20 million

2.4 SRA – investigations have prevented fraud of between £15 million and £20 million; 222 reports of suspected mortgage fraud in 12 months to 31 May 2010; 411 reports in 2009; mortgage fraud rose 500% in the 5 years to 2009 and is now valued at £700 million per year (2010).

2.5 Law Society – much of the £15 billion of criminal funds laundered in the UK is filtered through property transactions

2.6 City of London Police – investigating mortgage fraud worth millions in around 15 separate investigations in 2009-10

2.7 Council of Mortgage Lenders Annual Report 2011 – the CML has expressed its mounting concern over mortgage fraud.

## 3 What is mortgage fraud?

3.1 Borrower B obtains a loan in circumstances where, if the Lender L had known the true facts either about B or about the property upon which the loan was secured, or both, the loan would not have been made

3.2 Typically, misrepresentations of personal circumstances by B; over-valuation of the property; back-to-back sales to associate of B; use of false documentation by B

## **4 The position of solicitors**

- 4.1 The source of funds
- 4.2 Large cash transactions
- 4.3 Mismatch between value of property and client's income
- 4.4 "Conveyancers are uniquely vulnerable to criminals. They are often under pressure to exchange contracts quickly rather than risk the collapse of a chain of transactions. Mistakes are made and due diligence neglected because of the need to avoid delays."  
Peter Rodd, Law Society's money laundering task force.
- 4.5 "Professional criminals seek out and prey on conveyancing solicitors with a weakness requiring expenditure beyond their means, like an expensive drug habit. Such practitioners, out of desperation, can often be persuaded to collude with dubious deals. The number of conveyancers convicted of money laundering is low, however, although when one is caught the sums involved can be high."  
Unnamed SRA spokesman, reported in The Law Gazette, 16 June 2010.
- 4.6 Solicitors are in the main trustworthy – but provide a convenient defence for the fraudster (absence of attendance notes – "My solicitor said it was ok") and sadly it is often easier to spot a mortgage fraud once you have already experienced one.

## **5 The warning signs**

- 5.1 Back-to-back transactions where a property is bought and then sold quickly, apparently at a higher price. The lender advances money based on the higher price.
- 5.2 Misrepresentation or changes to the purchase price including sellers or developers providing incentives, allowances or discounts unless these are clearly and fully disclosed to the lender.
- 5.3 A representation to you that a deposit or part of the purchase price is paid direct.
- 5.4 "Gifted deposit" or "deposit paid" by the seller amounting to a reduction in the price paid by the buyer but distorting the value disclosed to the lender.
- 5.5 Unusual or suspicious instructions such as transactions controlled or funded by a third party; a client using an alias; sales and purchases between associates; parties using the same legal adviser; a request that net proceeds be sent to a third party.
- 5.6 Properties sold between related offshore or corporate companies that are commonly controlled by the same individuals, particularly where the properties are mortgaged at an inflated value.

- 5.7 Be aware that variations of these warning signs exist and fraudsters change their methods. A solicitor does not need to act for the lender to become implicated. If the solicitor is not satisfied of the propriety of the transaction, then refuse to act.
- 5.8 Bear in mind the legal obligations to report suspicions [as to money laundering] to the Serious Organised Crime Agency (SOCA).

## 6 Some history

- 6.1 The most productive source of solicitors' negligence litigation in the 1990s was work done by solicitors in relation to loans by Ls secured by mortgages on residential property.
- 6.2 The collapse of the housing market from the early 1990s left Ls who had in the mid to late 1980s and early 1990s advanced sums which represented a high proportion of the perceived value of the security property substantially out of pocket.
- 6.3 Bristol & West Building Society litigation – B&W were the first BS to bring multiple claims and by 2000 some 15-20,000 claims had been launched against solicitors.
- 6.4 The property market began to recover in the mid-1990s. But mortgage fraud never went away – it was easier to disguise it in a rising market. Rising property prices are a huge incentive for people to be “creative” with their personal circumstances to make a profit in the market.
- 6.5 Now, in present economic times, with Ls determined to find excuses to knock back as many mortgage applications as they can, Ls are now “finding” more cases of mortgage fraud. The truth is that these cases have never gone away.

## 7 Dishonesty – the test

- 7.1 If a claim arises out of dishonesty, the policy exclusion in clause 6 will apply.
- 7.2 In claims of deceit, convincing evidence is required to establish fraud, although it need only be proved to the civil standard of probability; the insurer must prove dishonesty on the balance of probabilities: *Re H* [1996] AC 563; *Re B* [2009] AC 11; *Re S-B* [2009] WLR (D) 365.
- 7.3 The starting point is the classic statement of the ingredients for a claim in deceit in the speech of Lord Herschell in *Derry v Peek* (1889) 14 AC 337 at 376:

“First, in order to sustain an order of deceit, there must be proof of fraud and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (i) knowingly, (ii) without belief in its truth or (iii) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent

a false statement from being fraudulent, there must I think, always be an honest belief in its truth.”

7.4 *Twinsectra v Yardley* [2002] 2 AC 164

“...before there can be a finding of dishonesty it must be established that the defendant’s conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest...”

...dishonesty requires knowledge by the defendant that what he was doing would be regarded as dishonest by honest people, although he should not escape a finding of dishonesty because he sets his own standards of honesty and does not regard as dishonest what he knows would offend the normally accepted standards of honest conduct.”

7.5 *Barlow Clowes International Ltd v Hamilton* [2006] 1WLR 1476

“...his knowledge of the transaction had to be such as to render his participation contrary to normally acceptable standards of honest conduct. It did not require that he should have had reflections about what those normally acceptable standards were.”

7.6 *Starglade Properties Ltd v Roland Nash* [2010] EWCA Civ 1314

“There is no suggestion in this case either that the standard of dishonesty is flexible or determined by any one other than by the court on an objective basis having regard to the ingredients of the combined test as explained by Lord Hutton in *Twinsectra* and Lord Hoffmann in *Barlow Clowes*”.

7.7 *Halliwells LLP v Nash* (23 February 2011, an unreported decision of HHJ McCahill QC)

Referring to the summary of the authorities in *Starglade*, the Judge said that that does not mean that *the* mental state of the person whose conduct is under consideration does not have to be considered at all; the Judge’s summary of the question was whether by ordinary standards the actual mental state of the individuals involved is to be characterised as dishonest.

7.8 *Secretary of State for Justice v Topland Group Plc and others* [2011] EWHC 983, a decision of King J (18 April 2011), the judge made a similar observation:

“First, on any current understanding of the law on accessory liability (see the analysis of recent authority by the Chancellor in *Starglade Properties Ltd v Nash* [2010] EWCA Civ 1314), although the test of dishonesty or put another way the standard of honesty, is an objective one, there being a single standard of honesty objectively determined by the court and the views of the Defendant on what is dishonest are irrelevant, (see *Barlow Clowes Ltd v Eurocrest Ltd* [2006] 1WLR 1476 where the Privy Council explained and interpreted the decision of the House of Lords in *Twinsectra v Ltd v Yardley* [2002] 2 AC 164)), the subjective state of mind of the Defendant, and what he knew or did not know

about the circumstances of the impugned transaction, is still highly relevant since it is to the conduct of the Defendant in the light of that subjective state of mind that the court has to apply the objective test.”

## 8 Sham Partnerships

8.1 *Partnership* is defined by the Partnership Act 1890, section 1(1), as:

“The relationship which subsists between persons carrying on a business in common with a view of profit”

8.2 Section 2 of the 1890 Act goes on to set out the following under the heading “Rules For Determining Existence Of Partnership”:

“In determining whether a partnership does or does not exist, regard shall be had to the following rules-

(1) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof.

(2) The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived.

(3) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; ...”

8.3 *M Young Legal Associates Limited v Zabid and others* [2006] EWCA 613

L became a partner in Z, a firm of solicitors, in order that the practice would meet the criteria of the Solicitors’ Practice Rules 1990 r.13 para.2, namely that the practice had a least one principal who was a solicitor qualified to supervise. In proceedings brought by a company against Z, L denied that he was a partner and accordingly a preliminary issue was raised to determine his status.

L stated that he was asked to join the practice so that Z could satisfy the 1990 Rules, and that it was agreed with the other partners that L would not contribute any capital to the firm, and that L would receive a fixed annual sum from the firm. He further argued that his position was little more than a figurehead.

The judge declared that L was a partner of Z. L argued that unless he was entitled to participate in the profits of the firm, including being entitled to a fixed payment directly linked to and dependent upon its profits, he was not in law a partner.

On appeal it was held that the words of the core definition as contained in section 1(1) of the 1890 Act were wide enough to render the recipient of payments in a fixed

sum a partner provided that there was a business, that it was carried on with a view to profit, and, crucially for the instant case, that he was carrying it on in common with another or others. It was inconsistent with section 1(1), and so not permitted by section 46, to graft on to its words the previous requirement of the common law for participation in profits. The provisions for payments to L of a fixed sum and for him not to be required to contribute capital to the firm pointed to the absence of a partnership. However, the need for the practice to comply with r.13 of the 1990 Rules was determinative. Its effect was that the firm could lawfully practice only if L was a partner in it. In that L and the other partners intended to comply with r.13, they must have intended to enter into a contract of partnership. Accordingly, the judge was correct to infer, that, notwithstanding the provisions for the firm's payment to L and for the absence of a contribution on his part to its capital, they succeeded in implementing their intention.

At paragraph 33, Tuckey LJ said:

“It is idle to deny that, indirectly, an employee has an interest in the profitability of the firm for the continuation of his job may well depend on it. Nevertheless the absence of a direct link between the level of payments and the profits of the firm is in most cases a strongly negative pointer towards the crucial conclusion as to whether the recipient is among those who are carrying on its business. But the conclusion must be informed by reference to all the features of the agreement. Thus, for example, provision or otherwise for a contribution on his part to the working capital of the firm will be relevant. And it will be important to discern whether, expressly or impliedly, the agreement provides not only that acts within his authority should bind the acknowledged partners but also that their such acts should bind him; for such is provided by section 5 of the Act to be a necessary incident of partnership but would, of course, be inconsistent with his status as an employee.”

At paragraph 41, Hughes LJ said:

“...the words of section 1 of the Act of 1890 seem to me to put the matter beyond doubt. They refer to the making of profit as an aim, but studiously abstain from reference to any necessity that it be shared. On principle it seems to me that if there is an essential element of partnership it is the carrying on of business in common, that is to say in such manner as to make each the agent of the other for all acts done in the course of the business. Having thus constituted themselves, the partners are free under the Act to arrange for the remuneration of themselves in any manner they choose, including by agreement that one or more shall receive specific sums, or that one or more receive nothing, in either case irrespective of profits.”

#### 8.4 *Rowlands v Hodson* [2009] EWCA Civ 1042

The appellant (R) appealed against a decision declaring that she had been a partner with another defendant (C) in a firm of solicitors (I). R's case was that she had sold

99 per cent of her practice to C and thereafter her involvement in the partnership business was effectively limited to satisfying the Law Society supervision requirement in respect of C, who was not sufficiently qualified to practise on his own without supervision. The Law Society later dispensed with the supervision requirement because of R's ill-health. R submitted that although she had signed a deed of partnership with C for three years there was no partnership in fact because from the outset she and C had implicitly agreed to a release of her one per cent interest in the profits and assets and after the grant of the supervision dispensation there had been an implied dissolution of the partnership.

The Court of Appeal held that the partnership deed undoubtedly purported to create a true partnership between C and R and it was not suggested that they intended by that deed to do other than create a genuine partnership between them or that it was in any respect a sham. The reason they set out to create a partnership was because they recognised that R needed to be in partnership with C in order to be able to provide supervision in compliance with the Solicitors' Practice Rules 1990. The terms of the deed covered the three requisites of a partnership required by the Partnership Act 1890 section 1: it provided for the establishment of a business to be carried on by two or more persons in common with a view of profit; and, following its execution, the two of them carried on such a business. R only carried out a very small proportion of work of her own for the partnership, but the fact that she was likely to do so was reflected in the nominal one per cent share in the partnership profits and business that she retained. It was, however, crucial that she was also intended to, and did, play an important role in supervising the practice, without which no business could have been carried on at all. Referring to *M Young Legal Associates Ltd v Zabid*, the Court of Appeal reiterated that the receipt of a share of profits was not a prerequisite of a claim to be a partner.

At paragraphs 20, Rimer LJ recited the first instance findings:

“The judge found that the deed of partnership created a partnership between Mrs Rowlands and Mr Cloutman. The three conditions of section 1 of the Partnership Act 1890 were satisfied, namely (i) a business, (ii) carried on by two or more persons in common, (iii) with a view of profit. He said this conclusion was supported by the fact that the purpose of the arrangement was to ensure that Mrs Rowlands could provide the required supervision of Mr Cloutman; and under rule 13 of the Solicitors' Practice Rules that supervision had to be provided by a partner. There was no suggestion that the partnership deed was a sham or that Mrs Rowlands and Mr Cloutman had merely pretended to comply with rule 13. Mrs Rowlands' case was, however, that although the parties had intended to comply with rule 13 they had failed. That was because the deed of partnership was not implemented. The reason for that was said to be: (i) there was no profit sharing, (ii) Mrs Rowlands took no benefit from the purported partnership, and (iii) she had no part in its management.”

As Rimer LJ noted at paragraph 21, the judge rejected each of these points as without substance.

“As to (i), Mrs Rowlands was entitled to a 1% profit share and if she chose to waive her entitlement to it, that was a matter for her. But an entitlement to share in profits was anyway not a condition of a partnership, as this court had decided in *M. Young Legal Associates Ltd v. Zabid Solicitors (a firm) and Others* [2006] EWCA Civ 613. As to (ii), nor was it a condition of a partnership that a partner should derive a benefit from the putative partnership; although, on the facts, Mrs Rowlands did derive a benefit from this partnership - the insurance cover and the use of the bank account, both of which she needed for the ‘private’ work she carried on for her scheduled clients and for the small amount of work she carried on for the partnership. As to (iii), Mrs Rowlands accepted that she discharged her supervisory duties down to 17 December 2001, and she therefore did have a limited involvement in partnership affairs, although such involvement was also not a condition of a partnership (cf the position of a sleeping partner). The judge therefore found that Mrs Rowlands was a partner from 1 August 2000 to 17 December 2001.”

At paragraph 37, Rimer LJ referred to the *Zabid* case:

“That case bore a close similarity to this one. It raised the question whether a retired solicitor who was asked to become a partner solely for the purpose of meeting the supervision requirements of the Solicitors’ Practice Rules 1990 became a true partner even though he had no share in partnership business or in its profits (he received a salary in a measure unrelated to the firm’s profits). It was held that he did become a true partner and this court upheld the decision.”

#### 8.5 *Protectacoat Firthglow Ltd v Szilagyi* [2009] EWCA 98

S had begun proceedings in the employment tribunal claiming that he had been unfairly dismissed by P. P argued that S was not an employee but was an independent contractor. The issue of S’s employment status was decided in a preliminary hearing. P asserted that S worked in partnership with others and that it had contracted with the partnership, relying on documents signed by S, which it said demonstrated the nature of the contractual relationship between it and the partnership. One was a partnership agreement between S and his assistants, and the other was a contract whereby the partnership undertook to provide services to P. The judge held that the documents were a sham and that S had been an employee. That decision was upheld by the EAT.

On appeal it was held that the judge had been entitled to conclude that both the partnership and the services agreements were shams. The test for a sham was context-sensitive and the court had to consider whether the words of the written contract represented the true intentions or expectations of the parties, not only at the inception of the contract but, if appropriate, as time went by. The question was

always what the true legal relationship was between the parties. If there was a contractual document, that was ordinarily where the answer was to be found. But if it was asserted that the document did not represent or describe the true relationship, the court had to decide what the true relationship was.

Smith LJ held at paragraph 56:

“Tribunals will be well aware that contracts may be partly written and partly oral and that they can also be constituted or evidenced by conduct. While a document which can be shown to be a sham designed to deceive others will be wholly disregarded in deciding what is the true relationship between the parties, it is not only in such a case that its contents cease to be definitive. If the evidence establishes that the true relationship was, and was intended to be, different from what is described in the document, then it is that relationship and not the document or the document alone which defines the contract.”

And at paragraph 60:

“It is well established that the fact that a document describes a relationship as a partnership is not the test for the existence of a partnership.”

And finally, having referred to section 1 of the Partnership Act, at paragraph 63:

“It seems to me clear that there was no real partnership between Mr Szilagyi and his assistants. They had no business in common. They had no common assets. They did not have a bank account. Their remuneration was paid directly into their individual bank accounts. If this had been a genuine partnership, payment would have been made directly to the partnership business account. It would have been of no concern to Protectacoat in what proportions any profits were to be shared; indeed that information would normally be confidential to the partners. In my view, it is clear on the evidence that these men signed ‘partnership agreements’ not with the intention of creating any business relationship between them but only for the purpose of satisfying a requirement of Protectacoat before they would be given any work. The ‘partnership agreements’ were entered into in order to create an illusion of partnership which would comply with the scheme which Protectacoat believed would avoid creating an employment relationship. They were shams.”

8.6 In the light of these authorities, it would appear that the signs of a true partnership, and conversely the indicia of a sham partnership, are as follows (or are to be determined by considering):

- The definition in section 1 of the 1890 Act is a core requirement – there must be a business in common carried on with a view to profit
- There is no requirement for participation in profit
- Evidence of an agreement that the acts of one partner within his authority would bind the other acknowledged partners

- A contribution of capital may be significant
- The existence of an apparent partnership agreement or other documentation, although not of itself conclusive; it is the evidence which will establish the true relationship, and not the description in a document
- It is not a condition that a partner derives a benefit from the putative partnership, although there may be evidence of such benefits, for example insurance cover or use of bank accounts; it may be significant if there is evidence of benefit
- The absence of a direct link between payment and profit is usually a strongly negative pointer
- There should be evidence of active participation in the accounting, regulatory and supervisory functions
- The test for a sham partnership is context-sensitive and the court should consider the position at the inception of the arrangement and as time goes by, and take into account all the circumstances, to answer the question, what was the true legal relationship between the parties?

8.7 Thus, where A and B enter into an arrangement under which they decide to present themselves to the outside world as a partnership called AB, but in reality they are in fact carrying out their own separate businesses and neither have any participative role in the other's business, that will not be a true partnership. It is a sham designed to dupe those contracting with the sham partnership into thinking they are contracting not with a sole practitioner (which is in fact the position) but with a two-partner firm. Both A and B will be dishonest, and in fact there will be no partnership.

8.8 That being the case, it is open to the insurer to contend that there is no partnership insured under the policy, and if AB is the entity described the insured person is in fact either A trading as AB or B trading as AB.

8.9 Where there is in fact a partnership between A and B, determined according to the 1890 Act and the authorities, but in fact the partnership was formed for a dishonest purpose – an extreme example would be where A and B decided to form AB in order to practice mortgage frauds on institutional lenders whose work they would not get as sole practitioners – the insurer can contend that any lenders claims against AB arose out of dishonesty. The success of such a contention depends on the insurer being able to prove that the claim actually arises out of dishonesty; for this, there needs to be some causal link between the dishonesty and the claim, although the dishonesty does not have to be the actual cause of the claim.

## Transactional and Structural dishonesty

- 8.10 Where, in a particular transaction, there is dishonesty on the part of any individual in relation to that transaction – using the AB partnership example, where A dishonestly signs a Certificate of Title knowing it to be false or reckless as to whether it is true or false – there will be no cover for A. This is what I will call “transactional dishonesty”. However, the insurer would still have to cover B if he was not involved in the dishonesty in relation to the particular transaction unless B condoned that dishonesty (for example, B knew about A’s transactional dishonesty but did nothing to prevent it).
- 8.11 An extreme example of condonation of fraud is to be found in *Zurich Professional Ltd v Karim and others* [2006] EWHC 3355.
- 8.12 In that case, there were two partners who were not involved in relevant transactions but who left the running of the firm to a third partner. As a matter of construction, Irwin J held that the words “dishonesty or a fraudulent act or omission committed or condoned by that Insured” did not require proof that each insured knew of the particular act of fraud, but that it was sufficient that each condoned a persistent course of dishonesty. This was an unusual case, because the two uninvolved partners were the son and daughter of the other partner, and it was held that they had condoned their mother’s dishonesty, not in relation to specific fraudulent acts or omissions, but generally. They knew that their mother was in sole charge of the firm even though they were nominally partners and that they were receiving money from the firm which could not legitimately have come from the firm’s income. This meant that they were “profoundly reckless” and “consistently dishonest” (para 102).
- 8.13 Irwin J put the issues in this way:
- “The concern is this: do the Claimants have to show that a given Defendant/insured either committed or condoned the specific ‘dishonesty’ or ‘fraudulent act or omission’ from which the claim arose? Or is it sufficient for avoidance of the claim, that an Insured should condone general practice or conduct which [1] was in fact dishonest or fraudulent [2] the Insured being at least reckless as to whether the general practice or conduct was dishonest, which [3] brings the conduct of the ‘condoning’ insured within the test of dishonesty as defined in either *Derry v Peek* or *Barlow Clowes*, and where [4] the general practice or conduct condoned led to or permitted the specific acts or omission giving rise to the claim?”
- 8.14 Irwin J held that the question is one of construction of the clause in the policy. He held that one cannot condone a specific act or omission which gives rise to civil liability if you are unaware of that specific act or omission. But he further held that the phrase “dishonesty or a fraudulent act or omission committed or condoned” is

intended to be disjunctive as between “dishonesty” and “a fraudulent act or omission” (para 108):

“I am in the end reinforced in this view by considering what the objective reasonable reading of such a contract would be – by the reasonable person on the Underground. Different responses to this situation might reasonably emerge from the person on the Underground, including surprise that such a contract permits insurers to stand aside from this kind of liability at all. Nevertheless, construing the document, it seems to me the reasonable person would be surprised if this clause allowed the Insurers to step aside from those within the firm who practised or condoned the specific forgery but not from partners who condoned persistent dishonest handling of money, breaches of the rules, and so forth, which allowed the specific act or omission to take place.”

8.15 For these reasons, Irwin J found that the insurers were entitled to avoid cover to the two partners.

8.16 *Goldsmith Williams v Travelers Inse Co Ltd* [2010] Lloyd's Rep IR 309

An insurer, who had insured a firm of solicitors against civil liability arising from its practice under a professional indemnity insurance policy, was not liable to a claimant in proceedings brought pursuant to the Third Parties (Rights against Insurers) Act 1930. The insured company's directors had either been engaged in or condoned mortgage frauds and the insurer was entitled to repudiate liability under the policy based on an exclusionary clause which provided that it was not liable in the event of the directors' fraud or dishonesty.

A solicitor insured can condone a dishonest course of conduct by a co-director (or partner) without being involved in, or specifically aware of, the fraudulent acts or omissions giving rise to the claim(s) in question.

In the context of the policy, the word “condone” was intended to convey a state of affairs where the non-dishonest director or partner knows of the dishonesty of his co-director or co-partner yet overlooks it and allows the business relationship to continue.

The phrase “...dishonesty or a fraudulent act or omission...” is intended to be disjunctive, as opposed to conjunctive (i.e. they are alternatives). If the position were otherwise, A could be aware that he was in practice with a dishonest and fraudulent solicitor, B, but the absence of knowledge of specific frauds committed by the latter would enable A to obtain indemnity from the firm's insurers. Such a result would fly in the face of both common sense and public policy generally.

8.17 Where A is transactionally dishonest, and B does not participate in or condone that actual dishonesty, but the partnership AB was either (i) established to enable frauds on lenders to be perpetrated and B knowingly or recklessly allowed that to happen,

or (ii) run in a way which to B's knowledge enabled frauds to be perpetrated and B knowingly or recklessly allowed that to happen, there will be what I will call "Structural Dishonesty". Any lenders claims can properly be characterised as either an example of claims arising from dishonesty or condoned dishonesty (in the sense set out in *Karim*).

## 9 Coverage issues

- 9.1 There will be no insurance cover for fraudulent solicitors and although cover extends to those insured who are not fraudulent (innocent partners), insurers look closely at whether there is cover or not.
- 9.2 To decline cover against the whole firm, insurers need to establish that all the partners/members/directors are dishonest.
- 9.3 Active involvement or dishonest participation is clear.
- 9.4 Holding out
  - Section 14(1) of the Partnership Act 1890 provides as follows:

“Every one who by words spoken or written or by conduct represents himself, or who knowingly suffers himself to be represented, as a partner in a particular firm, is liable as a partner to anyone who has on the faith of any such representation given credit to the firm, whether the representation has or has not been made or communicated to the person so giving credit by or with the knowledge of the apparent partner making the representation or suffering it to be made.”
  - Thus an honest partner (one who was not involved in the relevant transactions) would not be liable to L unless L can prove (a) holding out, (b) reliance thereon and (c) the consequent giving of credit to the firm.
  - The leading authority in this area is *Nationwide Building Society v (1) Lewis (2) Williams* [1998] Ch 482. BL and AW were solicitors. At all times BL was the sole principal of Brian Lewis & Co, and at the relevant times AW was a salaried partner whose name appeared as "Partner" on the notepaper. Nationwide retained the firm in a mortgage transaction. BL was later adjudged bankrupt and Nationwide sought to make AW liable. The issue was whether Nationwide had relied on AW being a partner. The Court of Appeal held that there was no evidence that Nationwide had placed any reliance on AW being named as a partner (a) when sending instructions to Brian Lewis & Co (in other words when the contract was formed) or (b) when relying on the Report on Title and releasing the mortgage advance.

- Nationwide had sought to infer reliance as a presumption but the Court of Appeal rejected that argument, holding that there had to be actual evidence of reliance to satisfy section 14(1) of the 1890 Act and that there was no such evidence.
- That case was decided in February 1998. It has been for some time common practice for Ls to require those firms it instructs to be on L's panel, and a firm can only be on the panel if the firm has more than one partner (Ls do not usually admit sole practitioners to the panel and do not usually instruct sole practitioners). Ls will usually argue that they did rely on the holding out of salaried partners because otherwise they would not have been instructing that firm. It was not argued in the Nationwide case that there was reliance because it would not have instructed Brian Lewis & Co had it known that the firm was truly a sole practitioner, and that may have been because it was not a requirement at that time that the lender would only instruct a firm with more than one partner.
- If Ls in any particular case can show, by evidence, that they did in fact rely on the fact of there being more than one partner when the contract was concluded (when the offer was accepted by the provision of the Certificate of Title), then L may well be able to establish reliance under section 14(1). One needs to look closely at how L puts its position on holding out and reliance and then review each case on its own facts.

#### 9.5 Number of claims

- This can affect recoverability of damages in substantial claims. The question is whether two or more claims fall to be treated as "One Claim" under the policy, which will usually provide as follows:
 

“(a) All Claims against anyone or more Insured arising from: (i) one act or omission; (ii) one series of related acts or omissions; (iii) the same act or omission in a series of related matters or transactions; (iv) similar acts or omissions in a series of related matters or transactions; and (b) all Claims against one or more Insured arising from one matter or transaction, will be regarded as one Claim.”
- The phrase “a series of related matters or transactions” incorporates two concepts. First, the matters or transactions must be “related”, and secondly the relation between them is that they are “a series”.
- The word “related” means that the matters or transactions must have a connection in a fairly broad sense.

- The word “series” means that there must be a unifying factor which is defined by the context in which the word is used. Here, the series must be related to the matters or transactions. In *Countrywide Assured Group plc v Marshall* [2003] Lloyds’ Rep IR195 Morison J had to consider the meaning of the word “series”:

“When is an occurrence part of a series of occurrences? To form part of a series there must be some connecting factor which links occurrences which would otherwise be separate. In the Australian case the majority considered that the occurrences must be of a sufficiently similar kind to qualify for forming part of a series. In this case the claims might properly all be described as occurrences of misselling of pensions. On the assumed facts the claims are sufficiently related to form part of a series; and that would be so, I think, whether or not they were attributable to one source or original cause.”

- The Australian case referred to there was *Distillers Company Biochemicals (Australia) Pty v Ajax Insurance Co Ltd* (1974) 130 CLR 1, in which it was held:
 

“The characteristic of the similarity of events which may form a series I take from those dictionary meanings of series which refer to the concept of being ‘of one kind’ or of having some ‘characteristics in common’ - Shorter Oxford English Dictionary.”
- Thus the words “series of related matters or transactions”, which must be looked at from the perspective of the insured, can be said to contemplate a number of matters or transactions which can properly be regarded as related to each other (in the sense of there being some connection between them) and coming one after another with some connecting factor linking their occurrence.
- In the claims, is there the same act or omission (failure to report an allowance, which ought to have been clear from the documentation); are the transactions related in that they are all close in time; are they are in relation to properties on the same development; were allowances paid to the same party?
- Is it arguable that the solicitors made themselves available to act for the same or connected party in order to further a mortgage fraud by that party? If so, this of itself may be sufficient, from the firm’s perspective, to form part of a scheme.

## 10 Some practical points

### 10.1 Consider the following:

- What has become of the advance moneys
- Is the property occupied and if so by whom and on what basis
- What is the value of the security
- Is the security subject to a valid charge in favour of L – and (of course) what was the role of L's solicitor – did the solicitor and any valuer act honestly and competently
- Can B be found and is B worth suing
- Can the fraudsters be identified and are they worth suing

#### 10.2 Information to be obtained:

- L's file relating to the mortgage application
- The deeds
- Land Registry – transfers, mortgage deeds, details of history of relevant transaction, names of solicitors acting for the parties
- Valuer – who made arrangements for inspection, occupation details
- Brokers if relevant
- Information from innocent parties
- L's solicitors – but under a duty to keep B's affairs confidential unless L or B permits disclosure – duty/privilege does not apply to communications between solicitor/client in furtherance of fraud or other crime – and if solicitor represents two parties in the transaction, must accept that an irreconcilable conflict may arise between duty to client A to keep information confidential and duty to client B to disclose that information

#### 10.3 Other steps:

- Investigating possible mortgage fraud
- Meeting/indemnity conference – reservation of rights – preservation of material

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