

THE ROLE OF THE NOTARY IN REAL ESTATE CONVEYANCING

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In the field of real estate, the notary's role of oversight and consulting extends to all aspects of the transaction: from verifying the title of the seller, to tax-related issues and choices, to ascertaining the legal zoning status of the property, to suggesting alternative solutions to improve the organization and distribution of family assets. In addition, should any errors be made that compromise the client's purchase, the notary is fully liable for compensation up to the entire current value of the property.

Conveyancing: modern development and new demands related to real estate transfers¹

For some time now, there has been a broad debate in the European Union regarding the regulation of competition, aimed at safeguarding consumers and promoting economic growth. This debate also includes a timely critical reassessment of the role of the legal professions, with a particular focus on the sector of real estate conveyancing, recognized as being fundamental for economic and social development.² For most people, real estate is one of the biggest investments of their lives, both financially and emotionally. Even economists recognize that the emotional value of a house for the owner far surpasses the objective market value.³ If we consider that 70 per cent of the Italian population owns their own home, and that on average, Italian families have invested 162,000 euros in real estate (while their

financial assets amount to approximately 25,000 euros and other miscellaneous assets to 20,000 euros),⁴ the political and social dimensions of a real estate purchase are abundantly apparent. However, real estate has assumed an ever more important role in an increasingly global economy as collateral to obtain credit. So called 'embedded capital value' is an important tool for overall economic growth. Taken together, the need for reliability and security in the circulation of real estate becomes increasingly important.

Since most people make one of the biggest financial and emotional investments of their lives when they buy a house, they are understandably averse to any risk, and would not consider monetary compensation adequate to make up for the loss of the property. In the credit world, growth and stability are based on the reliability of the collateral that backs it up, with the security of the title used as surety constituting a fundamental condition for granting credit. From this standpoint, the legal systems that guarantee the most security in attributing and accurately identifying property rights, as well as making their transfer quick, safe, and efficient, offer the best structural foundation for facilitating economic growth.⁵

Developing publicly registered property rights

Economists have recently begun analyzing how the system of publicly registering property rights affects economic development.⁶ One well-known example is

¹ The term is used here in a broad international connotation: the process of establishing, modifying, and extinguishing claims to real estate, both possession and liens, and both property transfers and mortgages.

² For instance, one can point to the degree to which real estate collateral can facilitate access to credit and render it more affordable under the standards of the Basel Revised international capital framework, which considers real estate collateral a fundamental tool for reducing Loss Given Default (LGD), one of the four parameters that determine both access to banking credit and its cost. The Basel Revised international capital framework, as is well known, affects all the banks of the G10 countries involved, and will have immediate, predictable repercussions on businesses and other participants.

³ In an economic analyses of the value of property, the indifference curve of the owner is represented by a curve whose convexity graphically indicates that the possessor does not view property and wealth as perfect substitutes: Thomas J. Miceli, *The Economic Approach to Law*, (Stanford University Press, 2004), 188.

⁴ Banca d'Italia, *I bilanci delle famiglie italiane 2004*, Supplement to *Bollettino Statistico* no. 7, 2006. On factors of household wealth accumulation in Italy, see T. Jappelli and L. Pistaferri, *The Dynamics of Household Wealth Accumulation in Italy*, CSEF Working Paper no. 27, 1999 (this data is cited by A. Forte in a study currently under preparation, which he kindly sent to the author).

⁵ R. Cooter, U. Mattei, P.G. Monateri, R. Pardolesi and T. Ulen, *Il mercato delle regole, Analisi*

economica del diritto civile, (Il Mulino, Bologna, 1999), 79.

⁶ Hernando De Soto, *The Mystery of Capital. Why Capitalism Triumphs in the West and Fails Everywhere Else*, (Basic Books, 2000); Kenneth W. Dam, "Land, Law and Economic Development" (January, 2006), U Chicago Law & Economics, Olin Working Paper No. 272, in <http://www.law.uchicago.edu/Lawecon/index.html>; Sebastian Galiani and Ernesto Schargrodsky, *Property Rights for the Poor: Effects of Land Titling*, CIF Documento de Trabajo 06/2005, available on-line at http://www.utdt.edu/Upload/CIF_wp/wpcfif-062005.pdf. These authors explore the relationship between reliable and secure real estate property rights and investments in human capital, which could help in reducing poverty.

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the work of economist Hernando De Soto, who has pointed out that a major obstacle to growth in many developing countries is the absence of efficient financial markets that allow people to transform property, first and foremost real estate, into financial capital.⁷ The problem, according to De Soto, lies not in the inadequacy of resources (which De Soto estimates at approximately 9.34 trillion dollars) but rather in the absence of a formal, public system for registering property rights that are guaranteed by the state in some way, and which allows owners to use property as collateral to obtain access to the financial capital associated with ownership. In his view, simple and secure real estate conveyancing is essential for markets to work efficiently, that is, for real estate to be used as collateral in obtaining credit.⁸ In economic terms, the certainty of ownership and the security of real estate circulation are thus public assets.⁹

Another factor that increases the need for certainty and security in property transactions is to be found in the strong international pressure from politicians to develop electronic real estate transactions, or e-conveyancing. This term is used to mean employing electronic methods to carry out the entire process of transferring (or establishing, amending, etc.) title to property, including its registration (i.e., enforceability against third parties);¹⁰ yet it is more intuitive than

theoretical that the reliability of the information in electronic registers depends entirely on adequate verification prior to entry; without this, rapid access to the registry loses all importance and all benefit, due to the intrinsic uselessness of unreliable data. Even in the Doing Business 2005 report commissioned by the World Bank,¹¹ it was pointed out that:

‘... technology is not a panacea ... If paper records are inaccurate, putting them in a computer won’t help. There, the focus must be on improving the efficiency of current services and the coverage and accuracy of the registry.’¹²

In other words, while there are very high expectations about the benefits that follow from the use of electronic technology, there is almost an equal emphasis on the technical issues and risks connected to it.

Risks of poor conveyancing structures

Clear evidence of these risks can be seen in the very rapid escalation, in common law countries, of criminal phenomena that are almost unheard of in civil law countries, at least in the sectors where notaries are involved. The phenomena related to mortgage fraud is particularly important, which the Mortgage Bankers Association estimates to have caused the American

⁷ Hernando De Soto, *The Mystery of Capital. Why Capitalism Triumphs in the West and Fails Everywhere Else*.

⁸ De Soto’s conclusion is confirmed by the empirical studies of many authors, including Alston, Lee J & Libecap, Gary D & Schneider, Robert, “The Determinants and Impact of Property Rights: Land Titles on the Brazilian Frontier,” *Journal of Law, Economics and Organization*, Oxford University Press, 1996, vol. 12(1), 25-61, April; Tim Besley “Property Rights and Investment Incentives: Theory and Evidence from Ghana,” *Journal of Political Economy*, 103, 5, 1995: 903-937; Thomas J. Miceli, C. F. Sirmans and Joseph Kieyah, “The Demand for Land Title Registration: Theory with Evidence from Kenya,” *American Law and Economics Review*, Volume 3 Number 2 2001, 275-287.

⁹ As such, their creation cannot be left to private initiative, in that the low level of profit would

discourage optimal production. Thus they are necessarily either directly supplied by the state, which finances payment by levying taxes, or commissioning certain categories of private parties to produce them; as a necessary form of compensation (otherwise their production would not be financially guaranteed), the latter must function within a monopoly system, though all of the basic aspects are controlled by the state to avoid negative repercussions for citizens.

¹⁰ This process fits into the much broader phenomenon of the use of advanced electronic technology by government authorities to make their services more efficient, less costly, and ensure increasingly broad connections and interaction between different public databases (information sharing). E-gov is meant to create high-quality, highly reliable services that are rapid and cost-effective, allowing tasks to be carried out remotely and eliminating related expenses. A project for e-

gov development has also been adopted by the European Union; as early as 1999, the Commission launched an eEurope initiative aimed at allowing EU citizens to benefit from all the advantages made possible by new information technology. Specifically, it recognized that the changes brought about by electronic technology are increasingly global in their scope, offering the opportunity to bring communities together, create wealth, and allow information sharing, with enormous growth potential.

¹¹ *Doing Business in 2005*, (World Bank, International Finance Corporation and Oxford University Press, 2005) available on-line at <http://www.doingbusiness.org/documents/DoingBusiness2005.PDF>. This Report clearly underlines the global interest in the phenomenon for the systems that are richest and therefore most involved and most influential.

¹² *Doing Business in 2005*, 39.

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system losses of 2.5 trillion dollars in 2005.¹³ This phenomenon is so serious and distressing, and is expanding to such a degree, that the Federal Bureau of Investigation has been monitoring it for some time now, and is actively collaborating with many public and private institutions to prevent its proliferation. Specifically, its partners in this effort have included the National Notary Association, precisely in order to help deal with the mortgage fraud problem.¹⁴

Mortgage fraud is carried out using different schemes whose fundamental common denominator is often the falsification of data regarding the property and, above all, of the participants' identity. According to a 2003 report by the Federal Trade Commission, this latter phenomenon, in particular misappropriation of identity in the form of the use of other people's data for criminal purposes, so-called 'identity theft,' affected 4.6 per cent of American consumers over the age of 18 (9.91 million people), with losses amounting to US\$52.5bn (US\$47.6bn for businesses and US\$5bn for private citizens).¹⁵ It is also significant that in civil law countries and in sectors where there is notarial verification, fraud-related phenomena are found only in very marginal cases.

The role of the notary in real estate conveyancing

In the 75¹⁶ countries whose legal systems include the Latin notary (or rather, given its global diffusion, the civil law notary), the field of real estate is traditionally entrusted to the notary, often along with the business sector. It is important to emphasize the close interdependent relationship between the notary and the continental or civil law system, to which the former is historically and inseparably linked, a system upon which the Italian system is based, and which overall (including mixed systems) represents in approximately 58 per cent of global Gross Domestic Product.¹⁷ This leads to analyse how this developed: if countries with such time-honoured and influential cultural and social traditions have adopted and continue to adopt this tool as a fundamental part of their systems, it is interesting to ponder whether this the result of rational choices in keeping with their historical, cultural, and social roots and matrices, rather than lobbying pressure, which would be hard to imagine, given the limited number of notaries. To explore this hypothesis, the roles entrusted to the notary will be set out, in both the legal system as a whole, and the real estate sector in particular.

¹³ Mortgage Asset Research Institute, Inc., operated by ChoicePoint Inc. produces an annual Research Report for the Mortgage Bankers Association of America, copies of which are available on-line at <http://www.mari-inc.com/reports.html>.

¹⁴ Financial Crimes Report to the Public, (Federal Bureau of Investigation, May 2005), available on-line at http://www.fbi.gov/publications/financial/fcs_reporto52005/fcs_reporto52005.htm#d1. See the partnership with the National Notary Association to combat mortgage fraud as underlined before the Senate Intelligence Committee: for instance, see "Congressional testimony of Robert Mueller, III Director of the FBI, before the Senate Committee on Intelligence of the United States Senate", given on February 16 2005, at <http://www.fbi.gov/congress/congresso5/mueller021605.htm>.

¹⁵ Federal Trade Commission – Identity Theft Survey Report (Prepared by Synovate, September 2003), Table 2, available on-line at

www.ftc.gov/os/2003/09/synovaterreport.pdf.

¹⁶ The notary, which for centuries has been a part of civil law systems based on the Roman legal tradition, is currently to be found in 75 countries around the world, including 21 of the 27 countries in the European Union, all of Latin America, part of Canada, Japan, Eastern Europe, and China.

¹⁷ Data published by the University of Ottawa at <http://www.droitcivil.uottawa.ca/world-legal-systems/fra-monde.php>. In the specific sector of real estate, the notary's role is inextricably linked to the numerous *clausus* principle of absolute rights and the particular effectiveness of land registry data in court; it is interesting to note that in the US, where these values are not officially shared, there is increasing acknowledgement that in economic terms, definite, secure identification of the title holders and nature of property rights reduces related transaction costs for research and identification, as well as defence and enforcement. In this regard, see Thomas W. Merrill and Henry E.

Smith, 'Optimal Standardization in the Law of Property: The numerous clauses Principle,' *Yale Law Journal*, Volume 110, October 2000; Thomas W. Merrill and Henry E. Smith, 'What Happened to Property in Law and Economics?' *Yale Law Journal*, Volume 111, November 2001, 357-398; Henry Hansmann and Reinier Kraakman, 'Property, Contract, and Verification: The numerous clauses Problem and the Divisibility of Rights,' Harvard Law School, Public Law Research Paper No. 37; Harvard Law and Economics Discussion Paper No. 388 (2001); for a civil law comment on the English and American debates about the numerous clauses principle, see reference to S. Van Erp, 'A numerous Semi-clauses of Property Rights as a Constitutive Element of a Future European Property Law?', (2003) in *Negozio di destinazione: percorsi verso un' espressionedell' autonomia privata*, available on-line at http://www.fondazioneotariato.it/download/Atti_Rimini_20060701.pdf.

The complexity is due, in part, to the international issues that are increasingly to be found both in family relationships and in transactions.

The role and duty of the notary

Notaries are required to fully understand the wishes of the parties that appear before them, and then translate them into specific legal terminology, providing an important legal consulting service (for which they are qualified by a rigorous competitive selection process) that is indissolubly linked to their public duties (as was acknowledged even by the European Parliament in the resolution it adopted based on the Marinho Report),⁴⁸ and thus characterized by impartiality and objectivity. In the field of real estate, the notary's consulting role extends to all aspects of the transaction: verifying the title of the seller, dealing with tax-related issues and choices, ascertaining the legal zoning status of the property and suggesting alternative solutions to improve the organization and distribution of family assets, which is a problem rendered more complex by the diffusion of extended families. Lastly, should any errors be made that compromise the client's purchase, the notary is fully liable for compensation up to the entire current value of the property.

Using the language of economic analysis, the notary's involvement minimizes the information gap that private citizens encounter in a regulatory framework that is increasingly complex. The complexity is due, in part, to the international issues that are increasingly to be found both in family relationships and in transactions. The role of the notary also reduces the transaction costs of finding a reliable consultant that private citizens

would otherwise have to shoulder (and do, in the English and American systems), given that the minimum standards of quality and content of the services provided are controlled, established, and tested by the State.

The legal status of the notary

An additional aspect is that notaries are public officials or representatives of the state, who are required to oversee the legally important aspects of contractual activities, for the double purpose of:

- a) creating secure agreements that comply with legal provisions and are not likely to give rise to legal disputes, in that the notary verifies their legality, preventing the completion of illegal agreements, which as such could be invalidated in court; and
- b) they grant legal reliability to the contractual information that the notary enters in the public registry (the land and business registers) so that anyone who consults it can consider the entry to be certain and are able to rely on it for legal purposes.

Benefits of notarial practices

Therefore, in real estate conveyancing notaries serve the public interest by verifying the legal zoning and construction status of the properties, making sure they comply with all public restrictions and interests (such as the state's right to first refusal for culturally important

⁴⁸ *The European Parliament, having regard to the Report of the Committee on Legal Affairs and Citizens' Rights (published in the Session Documents of 9 December 1993, A 30422/93), issued a resolution, dated 18 January 1994, on the situation and organization of notaries in the member States of the European Community, in which it stated, "... Aware that the activities of notaries are characterized by a partial delegation of State sovereignty, which guarantees the public service of the preparation of contracts and the legality, authenticity, and the executory and probative force thereof, as well as the advance provision of impartial advice to the interested*

parties, with a view to relieving congestion in the courts... We wish to recall that the notarial profession-although organized differently in each of the 12 member States of the Community and also within some States-is fundamentally characterized by a series of elements that are practically identical, which can be summarized as follows: partial delegation of State sovereignty to ensure the public service of authenticity of contracts and evidence; independent activity exercised in the framework of a public responsibility, under the form of a profession (with the exception of Portugal and one of the German Federated States, and a special system in the

United Kingdom), but subject to the oversight of the State-or the statutory body assigned to this task by the public authority-as regards the observance of clients' rules, access to the profession, and the organization thereof; function of hearing cases prior to a judge, in order to eliminate or reduce the number of cases of litigation; function of impartial adviser..."

properties); calculating and paying taxes related to the transaction. Above all, the notarial duty satisfies the public interest by checking and verifying basic information about the transaction, making it available to the community by entering it in the public registry, and so becoming the guarantor of its reliability from both a professional and financial standpoint. The role of the notary is expressly recognized at the European level, where more than once this meant justifying the exclusion of the notarial profession from the competition rules applied to other, even legal, professions.¹⁹

Again, using the language of economic analysis, entering reliable data in the public registry that refers to clearly, accurately determined property rights leads to considerable savings on transaction costs related to research and bargaining. Reliable data, that is, it is checked in advance, makes verification of ownership rapid, affordable, and within the power of most people, allows a safe, rapid circulation of real estate titles, and makes these titles clear and irrefutable, avoiding disputes and legal expense.²⁰

Notary involvement also has positive repercussions for the community in terms of assessing and collecting taxes related to private transactions. As mentioned earlier, the notary bears the direct obligation of collecting taxes related to the transfer of title. With a degree of trustworthiness that is not called into question by even the fiercest critics of the profession²¹ (in terms of corruption-proof calculation, honest payment practices, ability to redress errors), notaries are directly responsible for collecting the entire sum, without any compensation from the state, thus collecting assets that will become public, while saving on the costs of a public verification and collection system. In Italy in the year 2005, notaries calculated (under their direct and unlimited liability responsibility) and collected from real estate and business transactions, nearly 5bn euros (corresponding to 0.35 per cent of Italian gross domestic product) in taxes, at no cost to the public.

The role of verification carried out by notaries and the high reliability of notarial acts (due to the highly

competitive selection process for entering the profession) also provides a foundation for the special enforcement of notarial acts, which allows creditors to use them directly in enforcement against non-compliant debtors (without the need to obtain a court order). The savings in terms of legal transaction costs and rapid debt settlement is obvious and considerable. In the ever more frenetic pace of today's transactions, these factors have become more and more important, to the degree that they are increasingly acknowledged at the EU level.

Through notarial involvement, the Italian legal system, in addition to giving both parties the greatest possible assurance that they will obtain the legal assets they seek, and ensuring certain ownership and secure circulation of real estate, also manages to prevent to a considerable degree, through oversight before the transaction, the possibility of future disputes arising between the parties in regard to any other legal aspect of the contract. This characteristically preventative role of the notary is considered very important in civil law systems, in which litigation is seen as a negative, abnormal juncture in legal relations (which are damaged by it), as well as a considerable cost for society.

The Anglo-Saxon model

Until recently, the opposite idea was common in the English and American world, which see court rulings as an important creative source of law. It is interesting to observe, however, that the troubling increase in lawsuits seen in recent years, which has given the USA an unchallenged world record in litigiousness, has led to a distinct change in this conviction. What is taking shape in the US is a demand for reforms in the legal system capable of reining in the proliferation of lawsuits; and there is strong pressure to find alternative procedures for resolving disputes, such as the introduction of ADR (Alternative Dispute Resolution), as a means of reducing the increasing expense of the world's busiest legal system.

The difference between the civil law notarial system and the Anglo-Saxon model can be observed statistically, in the different number of post-contractual

¹⁹ See, for instance, Directive 2005/36/EC of the European Parliament and of the Council on the recognition of professional qualifications of 30 September 2005 (L255 OJ 22) of which Recital 41 reads: This Directive is without prejudice to the application of Articles 39(4) and 45 of the Treaty concerning notably notaries; and Directive of the European Parliament and of the Council of 12 December 2006 on services in the internal market, article 2(L): This Directive shall not apply to the following activities: services provided by notaries and bailiffs, who are appointed by an official act of

government; and article 17(12): acts requiring by law the involvement of a notary.

²⁰ Thomas W. Merrill and Henry E. Smith, 'Optimal Standardization in the Law of Property: The numerous clauses Principle,'; Thomas W. Merrill and Henry E. Smith, 'What Happened to Property in Law and Economics?' Henry Hansmann and Reinier Kraakman, 'Property, Contract, and Verification: The numerous clauses Problem and the Divisibility of Rights,'.

²¹ With others, Benito Arruñada, who, after an initial fondness for notaries (see Benito Arruñada, 'The

economics of notaries,' *European Journal of Law and Economics*, Volume 3, Number 1, March 2004, 1996, 5-37, available on-line at <http://www.econ.upf.es/~arrunada/research/files/F34.pdf> changed his opinion in successive papers, such as Benito Arruñada, *Managing Competition in Professional Services and the Burden of Inertia*, in Claus-Dieter Ehlermann and Isabela Atanasiu, eds., *European Competition Law Annual 2004: The Relationship between Competition Law and the (Liberal) Professions*, (Hart Publishing, Oxford and Portland Oregon, 2006), 51-71.

disputes found in fields subject to notarial oversight: in the US, the percentage is approximately 10 per cent, while in countries with civil law notaries it amounts to only 0.2 per cent.²²

In relation to the oft-mentioned information asymmetry, notary involvement in the real estate sector also seems to be an efficient solution in two ways. The first relates to the information asymmetry between professionals and their clients, which arises, according to the critics of liberal professions, because professionals have access to knowledge that their clients cannot assess, and are therefore incapable of judging correctly whether the service they receive is worth the price paid for it. In the case of civil law notaries, one instead observes that minimum standards of service are guaranteed by the state, through a rigorous initial selection process, and through the constant oversight provided by the notarial archives retained by the Ministry of Justice, which ascertain the quality of notarial acts with periodical official checks. The price of the service is established by a fee scale established by law, which is thus fully conscious of the value of the service and sets the limits precisely in order to prevent the discretionary calculation by notaries.

The second type of information asymmetry is to be found in relations between parties to the contract, for whom the task of ascertaining the counterparty's title and legitimacy is unquestionably becoming more and more difficult. From this standpoint, the notary involvement is aimed at removing the distortions of the information asymmetry, for the specific purpose of safeguarding both parties, but above all, the weaker of the two. The notary handles all the verifications that are necessary for the act to be legally effective, and explains the obligations that each party is taking on. The role of the notary is particularly important, for instance, in the field of loans, where banks have an infinitely greater advantage in terms of information, which they could use in an unscrupulous way to their exclusive benefit. In the real estate sector, therefore, notary involvement is all the more effective when it occurs in advance.

Concluding comments

In conclusion, it seems clear that the civil law system has outlined the role of the notary in a way that can rationally (and thus efficiently, in terms of cost-benefit analysis) offer a high degree of certainty regarding

property rights, and thus security in real estate conveyancing, which, as mentioned earlier, is emphasized on all sides as an essential factor in economic development. Moreover, it tends to result in the many other positive externalities pointed out earlier, to the benefit of the economic system and civil society as a whole.

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²² C. Licini, *I coralli emersi di Sumatra*, in *Rivista di Diritto Privato*, December 2006, 243.