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prescriptive right established. The emphasis was therefore shifted from the brute fact of the right or custom having existed in 1189 or there having been a lost grant (both of which were acknowledged to be fictions) to the quality of the 20-year user which would justify recognition of a prescriptive right or customary right. It became established that such user had to be, in the Latin phrase, nec vi, nec clam, nec precario: not by force, nor stealth, nor the licence of the owner. (For this requirement in the case of custom, see *Mills v. Colchester Corporation* (1867) L.R. 2 C.P. 476, 486.) The unifying element in these three vitiating circumstances was that each constituted a reason why it would not have been reasonable to expect the owner to resist the exercise of the right—in the first case, because rights should not be acquired by the use of force, in the second, because the owner would not have known of the user and in the third, because he had consented to the user, but for a limited period. So in *Dalton v. Angus & Co.* (1881) 6 App. Cas. 740, 773, Fry J. (advising the House of Lords) was able to rationalise the law of prescription as follows:

> "the whole-law of prescription and the whole law which governs the presumption or inference of a grant or covenant rest upon acquiescence. The courts and the judges have had recourse to various expedients for quieting the possession of persons in the exercise of rights which have not been resisted by the persons against whom they are exercised, but in all cases it appears to me that acquiescence and nothing else is the principle upon which these expedients rest."

In the case of easements, the legislature intervened to save the consciences of judges and juries by the Prescription Act 1832 (2 & 3 Will 4, c. 71), of which the short title was "An Act for shortening the Time of Prescription in certain cases." Section 2 (as amended by the Statute Law Revision (No. 2) Act 1888 (51 & 52 Vict. c. 57), section 1, Schedule and the Statute Law Revision Act 1890 (53 & 54 Vict. c. 33), section 1, Schedule 1) provided:

> "No claim which may be lawfully made at the common law, by custom, prescription, or grant, to any way or other easement [. . .] when such way or other matter [. . .] shall have been actually enjoyed by any person claiming right thereto without interruption for the full period of 20 years, shall be defeated or destroyed by showing only that such way or other matter was first enjoyed at any time prior to such period of 20 years, but nevertheless such claim may be defeated in any other way by which the same is now liable to be defeated [. . .]"

Thus in a claim under the Act, what mattered was the quality of enjoyment during the 20-year period. It had to be by a person "claiming right thereto" or, in the language of section 5 of the same Act (as amended by the Act of 1888), which dealt with the forms of pleadings, "as of right." In *Bright v. Walker* (1834) 1 C.M. & R. 211, 219, two years after the passing of the Act, Parke B. explained what these words meant. He said that the right must have been enjoyed "openly and in the manner that a person rightfully entitled would have used it" and not by stealth or by licence. In *Gardner v. Hodgson's Kingston Brewery Co. Ltd.* [1903] A.C. 229, 239, Lord Lindley said that the words "as of right" were intended "to have the same meaning as the older expression nec vi, nec clam, nec precario."

As Lord Hoffman explains, the user must be of a certain quality—that is, it must be open and exercised without force or the permission of the servient owner—and it must be established that this user has been exercised for one or more of the three prescription periods. Prescription at common law requires use from time immemorial, which means 1189; accordingly, a successful claim is most unlikely. Prescription by lost modern grant calls for proof of twenty years' user, which will lead to a presumption that a grant of the right had been made, but has now been lost. This presumption is strong and will not be rebutted

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by positive proof that no grant was made.[123] The Prescription Act 1832 operates by preventing a servient owner from contesting a claim at common law because the right could not have been exercised in 1189 where the claimant can prove user for the twenty years immediately preceding the commencement of proceedings in which the right is claimed. The Act also introduces a long prescription period, which operates positively to give rise to an absolute right on the expiry of the forty years' user.[124]

The Prescription Act 1832 has been much criticized as '*one of the worst drafted Acts on the Statute Book*'[125] and, as such, has not supplanted the fiction of lost modern grant. In particular, lost modern grant will operate whenever twenty years' uninterrupted user is established, even if that user was some time ago. In contrast to the Prescription Act 1832, the period of use does not have to continue up to the commencement of proceedings.

3.3.1 The basis of prescription

In Chapter 8, we saw that an adverse possessor may: (i) acquire a property right by taking possession of land; and (ii) later be able to rely on a limitation period that extinguishes the right of the paper owner to recover possession. Prescription operates in a different manner. Long user justifies a presumption or fiction that the servient owner has granted an easement. The presumption is founded upon the acquiescence of the servient owner in failing to prevent the dominant owner from exercising the claimed right.

Dalton v Angus & Co
(1881) 6 LR App Cas 740

Fry J

At 773

[I]n my opinion, the whole law of prescription and the whole law which governs the presumption or inference of a grant or covenant rests upon acquiescence. The Courts and the Judges have had recourse to various expedients for quieting the possession of persons in the exercise of rights which have not been resisted by the persons against whom they are exercised, but in all cases it appears to me that acquiescence and nothing else is the principle upon which these expedients rest. It becomes then of the highest importance to consider of what ingredients acquiescence consists. In many cases, as, for instance, in the case of that acquiescence which creates a right of way, it will be found to involve, 1st, the doing of some act by one man upon the land of another; 2ndly, the absence of right to do that act in the person doing it; 3rdly, the knowledge of the person affected by it that the act is done; 4thly, the power of the person affected by the act to prevent such act either by act on his part or by action in the Courts; and lastly, the abstinence by him from any such interference for such a

[123] See *Tehidy Minerals Ltd v Norman* [1971] 2 QB 518, 543, *per* Buckley LJ; *Mills v Silver* [1991] Ch 271, 278, *per* Dillon LJ. The presumption will be rebutted by proof that the grant could not have been made because of the incapacity of the servient owner, although incapacity may not affect the 40-year prescription period under the Prescription Act 1832 : see dicta of the Court of Appeal in *Housden v Conservators of Wimbledon and Putney Commons* [2008] EWCA Civ 200 [2008] 1 WLR 1172 noted at [2009] Conv 349. See also the recommendation of the Law Commission in Law Comm 327 (2011), [3.168].

[124] The forty-year period must also expire immediately before the commencement of proceedings in which the right is claimed.

[125] Law Reform Committee, *Fourteenth Report: Acquisition of Easements and Profits by Prescription* (Cmnd 3100, 1966), [40].

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length of time as renders it reasonable for the Courts to say that he shall not afterwards interfere to stop the act being done. In some other cases, as, for example, in the case of lights, some of these ingredients are wanting; but I cannot imagine any case of acquiescence in which there is not shewn to be in the servient owner: 1, a knowledge of the acts done; 2, a power in him to stop the acts or to sue in respect of them; and 3, an abstinence on his part from the exercise of such power. That such is the nature of acquiescence and that such is the ground upon which presumptions or inferences of grant or covenant may be made appears to me to be plain, both from reason, from maxim, and from the cases.

As regards the reason of the case, it is plain good sense to hold that a man who can stop an asserted right, or a continued user, and does not do so for a long time, may be told that he has lost his right by his delay and his negligence, and every presumption should therefore be made to quiet a possession thus acquired and enjoyed by the tacit consent of the sufferer. But there is no sense in binding a man by an enjoyment he cannot prevent, or quieting a possession which he could never disturb.

The fiction of a presumed grant raises the distinction that we made in Chapter 4 between *independent* and *dependent* acquisition. The fiction suggests that a prescriptive easement is acquired by dependent acquisition—that is, because a grant from A is presumed—rather than because of independent acquisition as a result of B's own unilateral conduct. McFarlane questions whether prescription really is a dependent grant.

McFarlane, *The Structure of Property Law* (2008, pp 864–5)

It is possible for B to acquire an Easement simply through the *consistent exercise, over a long period, of a right to use A's land*. This method of acquisition, referred to as *prescription*, looks very much like a form of independent acquisition:

1. B acquires the right through his own, independent conduct, without needing to show that A has exercised his power to give B an Easement.
2. Once B has behaved, for a long period, *as though* he has the right, it is no longer possible for A to deny B that right.

However, the courts do *not* currently treat prescription as an example of independent acquisition. Instead, when B acquires an Easement through long use, it is assumed that A, or a former owner of A's land, exercised his power to give B an Easement. Strictly speaking then, prescription is simply another type of implied grant. This approach seems puzzling: why should we rely on an (almost certainly incorrect) assumption that the claimed Easement was once granted by an owner of A's land to an owner of B's land? It would seem simpler to say that prescription is an example of an independent acquisition.

The idea that a grant of an easement by prescription is presumed has been the subject of much criticism. Indeed, it has been described as a 'revolting fiction'.[126]

Goymour provides a number of reasons why this approach is so misguided.

[126] *Angus v Dalton* (1877) LR 3 QBD 85, 94, *per* Lush J.

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Goymour, 'Rights in Property and the Effluxion of Time' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007, p 182)

First, the notion of a presumed grant is so fictitious that it offends common sense and is furthermore inconsistent with the technical requirements for prescription. The idea that prescriptive rights rest in a grant conflicts with the condition that prescription must be nec precario [without permission]. Any indication that the owner had given permission for another person to enjoy the land, whether by grant of an easement or merely a licence, will prevent a prescriptive right from arising. For the doctrine to be internally inconsistent is unsatisfactory.

Secondly, in conjunction with the first point, the technical mechanism of presumed grant has led to an acceptance by many that the policy rationale for prescriptive rights is 'acquiescence' by the servant owner in the other party's long-established enjoyment. So long as there is a theory of grant, it follows logically that acquiescence is relevant. However, it is far from obvious that acquiescence is the policy rationale for prescription, for the following reasons. First, as is apparent in the previous point, the requirement that use must be nec precario introduces an element of adversity into the prescriptive claim that cannot easily be explained by acquiescence. Furthermore, it is often equally fictitious to assume acquiescence on the part of the servient owner as it is to presume a grant. Finally the assumption that acquiescence is the rationale for prescriptive rights fails to take account of the fundamental distinction between rights that arise by consensual grant and rights that arise otherwise, by operation of law. The policy that lies behind the recognition of expressly granted rights can be explained by the law's respect for the wishes of the legal actors when they are executed in legally recognised forms, for which acquiescence is relevant. However, once it is accepted that prescriptive easements arise not by grant but by operation of law, it no longer follows that the policy justification for their existence is acquiescence [...]

The third problem with time's masked effect is linked to the first two. Because the law has inappropriately tied itself to the mechanism of grant and the rationale of acquiescence, the questions that occupy the courts in prescription cases tended to concern whether or not the technicalities of a hypothetical conveyance are satisfied [...] This focus comes at the expense of a proper consideration of why and in what circumstances long use should, as a matter of policy, give rise to a prescriptive right.

Clarke and Kohler point out that, whilst the presumption of a grant may make some (if unsatisfactory) sense to support positive easements by long user, the presumed grant of negative easements cannot be rationalized.

Clarke and Kohler, *Property Law* (2005, p 495)

There are two important points about negative easements. First, is the absence of an easement, I do not have a right to receive these forces, but only a liberty to make use of them. Secondly, when I exercise my liberty to enjoy these forces, I do not infringe *any rights* of yours [...] In other words, from the outset I had the liberty to receive the forces and you had the liberty to obstruct them. So from the outset I had no need of your authorisation to 'use' the light, or air, or support etc for twenty years: I would automatically receive them unless and until you exercised your liberty to interrupt them [...] It would be odd to infer from the fact that I have enjoyed uninterrupted receipt of these forces for twenty years that you

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positively promised not to interrupt them: this is a promise I had no need for, and you had no reason to give. A much more likely explanation is that you did nothing because you had no selfish reason to develop your land in a way that would interrupt my receipt of these forces.

A particular concern arises when a negative easement is claimed by prescription, because the right will arise even though there is no evidence of the user because the dominant owner has not made any positive use of the servient land. Lord Hope referred to this concern in the following case, in which the House of Lords canvassed (and rejected) possible redress (including the possibility of a new negative easement) for interference with television reception.

Hunter v Canary Wharf Ltd
[1997] AC 655, HL

Lord Hope

At 726

The presumption however is for freedom in the occupation and use of property. This presumption affects the way in which an easement may be constituted. A restraint on the owners' freedom of property can only be effected by agreement, by express grant or—in the case of the easement of light—by way of an exception to the general rule by prescription. The prospective developer should be able to detect by inspection or by inquiry what restrictions, if any, are imposed by this branch of the law on his freedom to develop his property. He should be able to know, before he puts his building up, whether it will constitute an infringement.

The presumption also affects the kinds of easement which the law will recognise. When the easements are negative in character—where they restrain the owners' freedom in the occupation and use of his property—they belong to certain well known categories. As they represent an anomaly in the law because they restrict the owners' freedom, the law takes care not to extend them beyond the categories which are well known to the law. It is one thing if what one is concerned with is a restriction which has been constituted by express grant or by agreement. Some elasticity in the recognised categories may be permitted in such a case, as the owner has agreed to restrict his own freedom. But it is another matter if what is being suggested is the acquisition of an easement by prescription. Where the easement is of a purely negative character, requiring no action to be taken by the other proprietor and effecting no change on the owner's property which might reveal its existence, it is important to keep to the recognised categories. A very strong case would require to be made out if they were to be extended. I do not think that that has been demonstrated in the present case.

The three existing forms of prescription at common law, under lost modern grant, and under the Prescription Act 1832 have been described as '*anomalous and undesirable*',[127] and the consequences of their interrelationship as '*messy overlaps*'.[128] The Law Commission have recommended that these three forms of the prescription should be replaced and prescription

127 *Tehidy Minerals Ltd v Norman* [1971] 2 QB 518, 543, *per* Buckley LJ

128 Goymour, 'Rights in Property and the Effluxion of Time' in *Modern Studies in Property Law: Vol 4* (ed Cooke, Oxford: Hart, 2007), p 185.

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should be based simply upon the passage of time,with a single prescription period of twenty years.[129]

3.3.2 User as of right

Given that the servient owner's acquiescence of the claimant's user underpins the prescription, the nature of that user is of central significance. The vital connection is explained in the following case.

Sturges v Bridgman
(1879) LR 11 Ch D 852

Thesiger LJ

At 863

Consent or acquiescence of the owner of the servient tenement lies at the root of prescription, and of the fiction of a lost grant, and hence the acts of user, which go to the proof of either the one or the other, must be, in the language of the civil law, nec vi nec clam, nec precario; for a man cannot, as a general rule, be said to consent to or acquiesce in the acquisition by his neighbour of an easement through an enjoyment of which he has no knowledge, actual or constructive or which he contests and endeavours to interrupt or which he temporarily licenses.

The phrase that describes the required user is that the claimant's user must be 'as of right'—a phrase that is discussed by Riddall.

Riddall, 'A False Trail: The Meaning of "As Of Right" in the Public Law of Prescription' (1997) Conv 199, 201

Since for the user to be "as of right" it must be nec vi, without force; nec clam, without secrecy; and nec precarious, without permission, the meaning of the phrase becomes apparent. User "as of right" means that the user must be in the same fashion *as if* there was a legal right to use the way. As the matter was expressed by Parke B in *Bright v Walker* (1834) 1 CM&R 211, user is as of right if exercised "in the same manner that a person rightfully entitled would have used it". In the same *manner*, this is the crux of the matter. Since this is what "as of right" means; its meaning cannot have anything to do with whether users believe that they are entitled to use a path. A person can use a path in the same *manner* as if he had a right to use it nec clam, nec vi and nec precario without having any shred of belief that he has a legal right to do so.

The question has arisen as to whether user can be as of right where the prescriptive user defers to the servient owner's continued use of the land. This issue looks to reconciling competing uses of the land as Lord Hope observes.

[129] Law Comm 327 (2011) [3.123]. The civilian systems look to the Roman law concept of *usucapio*, by which rights may be acquired by the passing of time.

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R (Lewis) v Recar & Cleveland Borough Council
[2010] UKSC 11, [2010] 2 AC 70

Facts: Local inhabitants had used a council owned golf course for recreation but had not interrupted the golfers' play by stopping when the golfers were playing their shots. Upon an application for the registration of the golf course as a town green, it was held that the local inhabitant's user was as of right despite the deference they had showed to the servient owner's user.

Lord Hope

At 75–6

But once one accepts, as I would do, that the rights on either side can coexist after registration subject to give and take on both sides, the part that deference has to play in determining whether the local inhabitants indulged in lawful sports or pastimes as of right takes on an entirely different aspect. The question is whether the user by the public was of such amount and in such manner as would reasonably be regarded as being the assertion of a public right. Deference by the public to what the owner does on his land may be taken as an indication that the two uses can in practice coexist.

Of course, the position may be that the two uses cannot sensibly coexist at all. But it would be wrong to assume, as the inspector did in this case, that deference to the owner's activities, even if it is as he put it overwhelming, is inconsistent with the assertion by the public to use of the land as of right for lawful sports and pastimes. It is simply attributable to an acceptance that where two or more rights coexist over the same land there may be occasions when they cannot practically be enjoyed simultaneously

We have seen that prescription looks to the intention of the servient owner rather than the prescriptive user as it is based upon a presumed grant by the servient owner. The competing uses and their possibly inconsistency should, thus, be viewed from the perspective of the servient owner. Lord Walker makes this point whilst characterizing the local inhabitant's use as mere civility and not deference to another's ownership. He does, however, also stress that the situation may differ where a private as opposed to a public right is being claimed.

Lord Walker

At [36]–[38]

[. . .] I have no difficulty in accepting that Lord Hoffmann was absolutely right, in Sunningwell [2000] 1 AC 335 , to say that the English theory of prescription is concerned with "how the matter would have appeared to the owner of the land" (or if there was an absentee owner, to a reasonable owner who was on the spot). But I have great difficulty in seeing how a reasonable owner would have concluded that the residents were not asserting a right to take recreation on the disputed land, simply because they normally showed civility (or, in the inspector's word, deference) towards members of the golf club who were out playing golf. It is not as if the residents took to their heels and vacated the land whenever they saw a golfer. They simply acted (as all the members of the court agree, in much the same terms) with courtesy and common sense. But courteous and sensible though they were (with occasional exceptions) the fact remains that they were regularly, in large numbers, crossing the fairways as well as walking on the rough, and often (it seems) failing to clear up after their dogs when they

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defecated. A reasonably alert owner of the land could not have failed to recognise that this user was the assertion of a right and would mature into an established right unless the owner took action to stop it (as the golf club tried to do, ineffectually, with the notices erected in 1998).

There is in my opinion a significant difference, on this point, between the acquisition of private and public rights. As between neighbours living in close proximity, what I have referred to as "body language" may be relevant. In a Canadian case of that sort, Henderson v Volk (1982) 35 OR (2d) 379, 384, Cory JA (delivering the judgment of the Court of Appeal of Ontario) observed:

> "It is different when a party seeks to establish a right-of-way for pedestrians over a sidewalk. In those circumstances the user sought to be established may not even be known to the owner of the servient tenement. In addition, the neighbourly acquiescence to its use during inclement weather or in times of emergency such as a last minute attempt to catch a bus, should not too readily be accepted as evidence of submission to the use. It is right and proper for the courts to proceed with caution before finding that title by prescription or by the doctrine of lost modern grant was established in a case such as this. It tends to subject a property owner to a burden without compensation. Its ready invocation may discourage acts of kindness and good neighbourliness; it may punish the kind and thoughtful and reward the aggressor."

That is, if I may say so, obviously good sense. But I do not think it has any application to a situation, such as the court now faces, in which open land owned by a local authority is regularly used, for various different forms of recreation, by a large number of local residents. The inspector's assessment did in my opinion amount to an error of law. He misdirected himself as to the significance of perfectly natural behaviour by the local residents.

The Latin phrase *nec vi, nec clam, nec precario*, meaning 'without force, without secrecy, and without permission', is commonly used to describe user as of right and the Law Commission's definition of qualifying user continues to rely upon these requirements.[130] We, thus, need to explore a little more the implications of this phrase.

The use of force refers not only to physical force, but also to the exercise of the right despite protests by the servient owner.

Smith v Brudenell-Bruce
[2002] 2 P & CR 51, HC

Pumfrey J

At [12]

It seems to me a user ceases to be user "as of right" if the circumstances are such as to indicate to the dominant owner, or to a reasonable man with the dominant owner's knowledge of the circumstances, that the servient owner actually objects and continues to object and will back his objection either by physical obstruction or by legal action. A user is contentious when the servient owner is doing everything, consistent with his means and proportionately to the user, to contest and to endeavour to interrupt the user.

[130] Ibid.

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Thus, the breaking down of fences or breaking through locked gates will amount to force. Ignoring prohibitory signs may not be a forceful action unless the signs themselves are suitably worded and maintained by the servient owner against the risk of removal.[131]

There has been some controversy over the circumstances in which an illegal user can qualify as user as of right. At first sight, it might seem inappropriate to condone any illegal user, but, until the prescription period has expired, the claimants user is inevitably illegal—in the sense that it is a trespass. The House of Lords has settled the controversy by distinguishing between those illegal actions that the servient owner cannot legitimatize and those actions that would cease to be illegal if the servient owner were to choose to permit their exercise. The Law Commission recommendations adopt this distinction.[132]

Bakewell Management Ltd v Brandwood
[2004] 2 AC 519, HL

Facts: The owners of several houses adjoining Newtown Common had driven over the common via a track to gain access to their homes. The common came into the ownership of Bakewell, which demanded payment for the house owners' continued use of the track. The owners successfully claimed a right of way over the track by prescription, although their user was illegal, being a breach of s 193(4) of the Law of Property Act 1925 (as amended).

Lord Scott

At [46]–[47]

It is accepted, however, that a prescriptive right, or a right under the lost modern grant fiction, can be obtained by long use that throughout was illegal in the sense of being tortious. That is how prescription operates. Public policy does not prevent conduct illegal in that sense from leading to the acquisition of property rights. The decision in *Hanning's case* can only be justified on the footing that conduct illegal in a criminal sense is, for public policy purposes, different in kind from conduct illegal in a tortious sense. Why should that necessarily be so? Why, in particular, should it be so where the conduct in question is use of land that is not a criminal use of land against which the public law sets its face in all cases? It is criminal only because it is a user of land for which the landowner has given no "lawful authority". In that respect, the use of land made criminal by section 193(4) of the 1925 Act, or by section 34(1) of the 1988 Act, has much more in common with use of land that is illegal because it is tortious than with use of land that is illegal because it is criminal.

In my opinion, if an easement over land can be lawfully granted by the landowner the easement can be acquired either by prescription under section 2 of the 1832 Act or by the fiction of lost modern grant whether the use relied on is illegal in the criminal sense or merely in the tortious sense. I can see no valid reason of public policy to bar that acquisition.

The user must not be secret, in the sense that a reasonable person in the position of the servient owner should be able to discover that the right is being exercised. A servient owner cannot acquiesce unless he or she knows, or ought to have known, of the exercise of the right.

131 See *R (Beresford) v Sunderland CC* [2003] UKHL 60 [2004] 1 AC 889, [72], *per* Lord Walker.
132 Law Comm 327 (2011), [3.123].

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Union Lighterage Co v London Graving Dock Co
[1902] 2 Ch 557, CA

Facts: A dry dock was secured to an adjoining wharf by underground rods, which were not visible to the eye. The owner of the dock failed in his claim for an easement of support by prescription, because the Court decided that his user was not reasonably discoverable.

Romer LJ

At 570

Now, on principle, it appears to me that a prescriptive right to an easement over a man's land should only be acquired when the enjoyment has been open—that is to say, of such a character that an ordinary owner of the land, diligent in the protection of his interests, would have, or must be taken to have, a reasonable opportunity of becoming aware of that enjoyment. And I think on the balance of authority that this principle has been recognised as the law, and ought to be followed by us. In support of this statement I do not think it necessary to do more than refer to those parts, which deal with this point, of the speeches made by Lord Selborne and Lord Penzance in the House of Lords in *Dalton v. Angus* (1881) 6 App Cas 740, and I gather that their views as there expressed on this point were not dissented from by the other members of the House who took part in the hearing of that case, and, indeed, Lord Blackburn said at 827 that no prescriptive right "can be acquired where there is any concealment, and probably none where the enjoyment has not been open."

Although the right of support failed in *Union Lighterage*, it is clear that rights of support are not inherently secret, they may be evident from the way in which buildings are constructed.[133]

The permission of the servient owner to the claimant's exercise of the right will prevent prescription. Although, in the following case, the House of Lords decided that no permission had been given, they acknowledged that permission might be implied as well as express.

R (Berrisford) v Sunderland CC
[2008] UKHL 60

Facts: An open area had been grassed over by the local authority and seats installed. The local inhabitants used the area for recreation whilst the local authority continued to maintain it. A successful application was made for the registration of the area as a village green based upon the local inhabitants prescriptive user.

Lord Rogers

At 56–61

It is not suggested that members of the public used the sports arena vi, by force: the owners did not try to stop them and so there was no question of them overcoming any resistance on the owners' part. Equally, the public were not enjoying themselves clam, by stealth: on the

133 *Dalton v Angus & Co* (1881) 6 LR App Cas 740, *per* Lord Selbourne at [798].

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contrary, they used the land openly and the owners knew what was going on. The council concluded, however, that the local residents and others enjoying the land had been doing so precario, by virtue of the licence of the owners of the land. Admittedly, there was nothing to show that the owners had given any express permission or licence to the public. But the facts as a whole, and cutting the grass and constructing the seating in particular, showed that the owners had actively encouraged the use of the area for recreation and so had impliedly granted a licence, or given permission, for it to be used in that way. Use of the land by virtue of this licence or permission could not constitute use "as of right" for purposes of section 22(1) of the 1965 Act. Smith J [2001] 1 WLR 1327 dismissed Mrs Beresford's application for certiorari to quash the council's decision, and the Court of Appeal [2002] QB 874 dismissed her appeal.

In Roman law "precarium" is the name given to a gratuitous grant of enjoyment of land or goods which is revocable at will. The arrangement is informal and is based on the grantor's goodwill, whether more or less enthusiastic. But, however informal, the arrangement does involve a positive act of granting the use of the property, as opposed to mere acquiescence in its use [. . .]

In De legibus et consuetudinibus Angliae Bracton took over the noun precarium and its congeners from the vocabulary of Roman law and used them in a number of contexts, but always with reference to a gratuitous grant which is revocable at any time at the grantor's pleasure. See, for instance, lib 2 ff 52 and 52b. In lib 4 f 221 Bracton discusses the acquisition of easements by use for some time nec vi nec clam nec precario—the last being, the author says, the same as de gratia, of grace. Under reference to the second of these passages, in speaking of the use of a watercourse in Burrows v Lang [1901] 2 Ch 502, 510, Farwell J asked "What is precarious?" and answered his own question: "That which depends, not on right, but on the will of another person." Some years before, in Sturges v Bridgman (1879) 11 Ch D 852, 863, Thesiger LJ had indicated that, if a man "temporarily licenses" his neighbour's enjoyment, that enjoyment is precario in terms of the civil law phrase "nec vi nec clam nec precario". It is important to notice that, in this regard, English law distinguishes between an owner who grants such a temporary licence or permission for an activity and an owner who merely acquiesces in it: Gale on Easements, 17th ed (2002), para 4-83. Someone who acts with the mere acquiescence of the owner does so nec precario.

The council were, accordingly, entitled to refuse Mrs Beresford's application for registration of the area as a town or village green only if those who used the sports arena did so by the revocable will of the owners of the land, that is to say, by virtue of a licence which the owners had granted in their favour and could have withdrawn at any time. The grant of such a licence to those using the ground must have comprised a positive act by the owners, as opposed to their mere acquiescence in the use being made of the land. Prudent landowners will often indicate expressly, by a notice in appropriate terms or in some other way, when they are licensing or permitting the public to use their land during their pleasure only. But I see no reason in principle why, in an appropriate case, the implied grant of such a revocable licence or permission could not be established by inference from the relevant circumstances.

In the present case the owners did not expressly license the use of the land by the public. The council rely on two circumstances, however, as justifying the inference that those who used the sports arena did so precario, merely by licence from the owners of the land. The first is that the owners cut the grass. But that is at least equally explicable on the basis that the owners were concerned, as many owners would be, for the appearance of such a large and prominent area of open land in the heart of the town. Like charity, care of amenities begins at home. The second matter relied on is the, now rather dilapidated, wooden seating along the

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perimeter. Whatever may have been its original purpose, the continued existence of the seating is consistent with the owners of the land having acquiesced, perhaps quite happily, in people using the area for football or other games which their friends or relatives would wish, or feel obliged, to watch. To an extent the owners may thus have encouraged these activities. The mere fact that a landowner encourages an activity on his land does not indicate, however, that it takes place only by virtue of his revocable permission. In brief, neither cutting the grass nor constructing and leaving the seating in place justifies an inference that the owners of the sports arena positively granted a licence to local residents and others, who were then to be regarded as using the land by virtue of that licence, which the owners could withdraw at any time.

In these circumstances I would conclude that local people used the land nec precario.

As Lord Rogers makes clear, in the above extract, it is important to distinguish permission from the servient owner's acquiescence, which underlies prescription. It is clear that toleration of user without objection does not constitute permission; some positive approval is needed.[134] The inter-relationship between acquiescence and user as of right is fundamental, as Meager explains:

Meager, Prescription and User 'As of Right': Ripe for Wholesale Reform? in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford Hart: 2011, p 254)

Notwithstanding the apparent importance of acquiescence and its role in establishing that user has been of right, it does not appear to be an added component of the as of right test. Its role is simply confined to a recognition that, in the face of user which is nec vi, nec clam, nec precario, it is necessary for the landowner to do something, to take some positive steps, to bring the user to an end; acquiescence, as a matter of fact, in the face of such user, will be determinative that user as of right is continuing.

Meager goes on to suggest that, even though the Law Commission's proposal that prescription be established solely by qualifying long user may suggest that acquiescence should no longer underpin prescription, 'it will be impossible to depart from the many judicial statements which recognise the central importance of acquiescence' and, in order to prove prescriptive use, to 'sever the link between acquiescence and user as of right.'[135]

3.3.3 User in fee simple

The presumption that a permanent grant has been made at some time in the past dictates that prescriptive user must be by, and against, a fee simple owner.[136] A lessee thus cannot acquire a prescriptive easement over adjoining land held either by his or her landlord or by anyone else.[137] This position has been criticized, for instance, by Lord Millett when sitting as a judge of the Final Court of Appeal in Hong Kong where the rule is particular significant as all land

134 See also *Mills v Silver* [1991] Ch 271 at 279–81; *London Tara Hotel Ltd v Kensington Close Hotel Ltd* [2010] EWHC 2749.

135 Meager, Prescription and User 'As of Right': Ripe for Wholesale Reform? in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011), p 254.

136 *Simmons v Dobson* [1991] 1 WLR 720; *Kilgour v Gaddes* [1904] 1 KB 457.

137 The benefit of their prescriptive user accrues to the holder of the freehold.

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is leasehold. Indeed in *China Field* the Hong Kong Final Court of Appeal abandoned the rule.[138]

China Field Ltd v Appeal Tribunal (Buildings)
[2009] HKCU 1650

> The [fee simple] rule is both counter intuitive and contrary to the policy of the law. It is counter intuitive because it is difficult to see why it should be impossible to presume a lost grant of an easement by or to a lessee for the term of his lease when such a grant may be made expressly [. . .] It is contrary to the policy of the law, for if the disturbance of long established de facto enjoyment of a right is contrary to legal policy, then this is equally the case whether the enjoyment is by or against a freeholder or leaseholder.

However, there are no proposals to follow suit in this jurisdiction. Law Commission has abandoned its proposals to extend the benefit of prescription to leaseholders because they wish to keep prescription within narrow confines.[139]

An owner of dominant land also is unable to claim prescription against servient land that is let, when the servient freehold owner cannot object to the use either because they did not know about it or because they were unable to take any action to stop it under the terms of their lease.[140] However, where the prescriptive user is initiated between freehold owners, the subsequent grant of a lease, either of the dominant or servient land, will not interrupt the prescription period.[141]

3.3.4 The function of prescription

Lord Hoffman in *Sunningwell*[142] noted that '[a]*ny legal system must have rules of prescription which prevent the disturbance of long-established de facto enjoyment*'. The Law Commission, in rejecting the abolition of prescription, has summarized the most important arguments for and against prescription.

Law Commission, Law Comm 327 *Easements, Covenants and Profits à Prendre* (2011)

> At [3.75]–[3.76]
>
> The arguments in favour of retention are that prescription has proved invaluable over the centuries as a way of regularising long use, bringing the legal position into line with practical reality. More specifically, it is valued as a way of ensuring the continuation of facilities that are essential to the use and marketability of land, and making good omissions in conveyancing.
>
> However, the other side of the coin is that prescription penalises neighbourliness and generosity. A landowner who has made no objection to a neighbour's walking across his or her land may regard it as unfair if that tolerance eventually leads to the land being burdened with a legal easement.

138 Noted at [2010] Conv 176.
139 Law Comm 327 (2011), [3.150]
140 *Williams v Sandy Lane (Chester) Ltd* [2006] EWCA Civ 1738 and *Llewellyn v Lorey* [2011] EWCA Civ 37. See also Law Commission's proposals to codify this position in Law Comm 327 (2011), [3.127].
141 *Pugh v Savage* [1970] 2 QB 373.
142 [2000] 1 AC 335, 349.

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4 EASEMENTS: THE DEFENCES QUESTION

4.1 REGISTERED LAND

We have already explored the aim of the LRA 2002 that the register '*should be a complete and accurate reflection of the state of the title of the land*'.[143] Easements presented a challenge to that goal, stemming from the fact that easements can arise by express, implied, and presumed grant, and that, under the Land Registration Act 1925 (LRA 1925), all easements potentially took effect as overriding interests.[144] Thus legal easements (whether arising by express, implied, or presumed grant) did not need to be entered on the register to bind a third party, although it was common practice for express easements to be so recorded. Somewhat controversially, equitable easements—arising, for example, from an agreement to create an easement—were also held to take effect as overriding interests, provided that they were openly enjoyed.[145]

The LRA 2002 has risen to the challenge by providing that:

- easements that are protected by registration will bind a purchaser;[146]
- easements created before the Act came into force on 13 October 2003, which are not protected by registration, but which are overriding interests, will continue to override;[147]
- an express easement created after 13 October 2003 must be registered if it is to take effect as a legal easement;[148]
- an equitable easement created after 13 October 2003 can no longer count as an overriding interest in its own right and so is vulnerable to the lack of registration defence (see Chapter 12, section 3.2, and Chapter 14, section 5);
- implied or presumed legal easements will only override if certain conditions are met – see Sch 3, paragraph 3 extracted below.

Implied easements arising by necessity, common intention, under *Wheeldon v Burrows*, or by the operation of s 62 of the LPA 1925, and presumed easements created by prescription present a particular problem to a system of title by registration.[149] If the grant or reservation of such an easement is implied into the grant or reservation of a legal estate in land, the implied easement will be a *legal* interest in land. Similarly, an easement arising by prescription is also a legal easement, of which there need be no documentary record. Such legal easements may be difficult to discover, because there is no express grant that can be lodged at the Land Registry.

The LRA 2002 seeks to overcome this problem by providing that implied and presumed legal easements will only override if they satisfy certain conditions that focus upon their discoverability.

143 Law Commission Report No 271, *Land Registration for the Twenty-First Century: A Conveyancing Revolution* (2001), [1.5]. See further Chapter 14.

144 Land Registration Act 1925, s 70(1)a.

145 *Celsteel Ltd v Alton House Holdings Ltd* [1985] 1 WLR 204, reversed in part on another point [1986] 1 WLR 512.

146 Land Registration Act 2002, s 29(2)(a).

147 Ibid, Sch 12, para 9.

148 Ibid, s 27.

149 See Burns (2008).

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Land Registration Act 2002, Sch 3, para 3

(1) A legal easement or profit a prendre, except for an easement, or a profit a prendre which is not registered under the Common Registration Act 1965 (c64) which at the time of the disposition—

(a) is not within the actual knowledge of the person to whom the disposition is made, and

(b) would not have been obvious on a reasonably careful inspection of the land over which the easement or profit is exerciseable.

(2) The exception in sub-paragraph (1) does not apply if the person entitled to the easement or profit proves that it has been exercised in the period of one year ending with the day of the disposition.

Thus, an implied or presumed legal easement created after 13 October 2003 will only bind a purchaser of the servient land if the purchaser knew, or should have known from a reasonably careful inspection of the servient land, of the easement, or the easement had been exercised by the dominant owner in the year preceding the sale. Those easements that fail to satisfy these conditions will vanish upon a disposal of the servient land, because they will not bind a registered purchaser for value.[150] A dominant owner claiming the benefit of an implied or presumed easement, however, may avoid this unhappy result by applying to have the easement registered.[151]

4.2 UNREGISTERED LAND

The priority rules governing easements where the land is unregistered are relatively straightforward. Legal easements, whether arising by express, implied, or presumed grant, bind a purchaser of the servient land. Equitable easements, however, only bind if they are protected by entry in the land charges register as a Class D(iii) land charge.[152]

A disposal of the servient land, whether by way of transfer, a lease for more than seven years, or first mortgage, will now trigger first registration of that land.[153] Existing legal easements over the servient land (whether by express, implied, or presumed grant) will, on first registration, bind the purchaser as overriding interests.[154] Equitable easements will not, however, bind a purchaser of the servient land and the owner of the dominant land is well advised to lodge a caution against first registration of the servient land, so that they can assert their right against any purchaser.[155]

5 EXCESSIVE USER

Where a dominant owner exceeds the ambit of the right that he or she has been granted, the servient owner, or another dominant owner whose own rights are affected, may seek redress in nuisance for excessive user. That redress may include the grant of an injunction or an

[150] Kenny, 'Vanishing Easements in Registered Land' [2003] Conv 304; Battersby, 'More Thoughts on Easements under the Land Registration Act 2002' [2005] Conv 195.
[151] Land Registration Rules 2003 (SI 2003/1417), r 74. [152] See Chapter 13, section 5.2.
[153] Land Registration Act 2002, s 4. [154] Ibid, Sch 1, para 3. [155] Ibid, Pt 2.

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award of compensatory damages, or, in extreme cases, the extinguishment of the easement. In addition, a servient or another dominant owner may take self-help measures to stop the excessive user.

Whether or not a user is excessive will depend on the terms of the grant. Where the easement has been expressly granted, that will be determined by looking at the terms of the deed. Where the easement is implied or presumed, the courts will look at the use and the nature of the land at the time of the implied or presumed grant.[156] A mere increase in user will not be excessive; what is required is a radical change in the character of the user of the dominant land, which leads to a substantial increase in the burden that user places upon the servient land.

The Court of Appeal considered the question of excessive user in the following case.

McAdams Homes Ltd v Robinson
[2005] 1 P & CR 30, CA

Facts: The MacAdams built two homes on the site of an old bakery, which enjoyed a right of drainage over Robinson's land under *Wheeldon v Burrows*. Robinson successfully prevented McAdams from using the drain once the two houses were built, because the Court of Appeal found that McAdams' user was excessive, representing a substantial increase in the burden on the servient land.

Lord Neuberger

At [50]–[51]

The authorities discussed above appear to me to indicate that that issue should have been determined by answering two questions. Those questions are:

i) whether the development of the dominant land, ie the site, represented a "radical change in the character" or a "change in the identity" of the site [...] as opposed to a mere change or intensification in the use of the site [...]

ii) whether the use of the site as redeveloped would result in a substantial increase or alteration in the burden on the servient land, ie the cottage [...]

In my opinion, the effect of the authorities in relation to the present case is that it would only be if the redevelopment of the site represented a radical change in its character and it would lead to a substantial increase in the burden, that the dominant owner's right to enjoy the easement of passage of water through the pipe would be suspended or lost.

At 55

The [...] potentially unsatisfactory feature of the approach I have suggested is that both questions could be said to involve an exercise which, in many circumstances, may have a rather uncertain outcome. What may appear to be "a radical change in character" to one judge could easily appear differently to another judge; equally, one judge may consider a particular increase in the burden on the servient land to be "substantial", whereas another judge may not. It is, perhaps, inevitable that the questions have to be expressed in this rather generalised way, because each case will very much turn on its own facts, with regard to the particular easement, the position on the ground at the date of grant, the surrounding circumstances at the date of grant, and the nature and effect of the redevelopment that has

[156] *British Railways Board v Glass* [1965] Ch 538.

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subsequently taken place. What [the] cases [. . .] demonstrate is that, before a change of use or redevelopment can be sufficiently substantial for the servient owner to succeed on the first question, it really must involve something "radical". Similarly, before the servient owner can succeed on the second question, the cases show that the court must be satisfied that there has not merely been an increase (or change) in the enjoyment of the easement as a result of the changed character of the dominant land, but that there has been a real increase (or change) in the burden on the servient land.

6 EXTINGUISHMENT OF EASEMENTS

We have already seen that an easement will be extinguished, in the case of freehold land, where the dominant and servient land come into common ownership, and will be suspended, in the case of leasehold land, where the dominant and servient land come into common occupation.[157] We have also considered when an easement attached to a lease will be extinguished upon the termination of that lease.[158]

The dominant and servient owners may bring an easement to an end by express release and, more controversially, a release may also be implied as a result of abandonment.[159] An easement is abandoned if the dominant owner acts, or fails to act, with an intention to relinquish the right. The permanence of proprietary rights is demonstrated by the difficulty of proving that intention.[160] The fact of non-user does not raise any presumption of abandonment;[161] something more is required—particularly where the right by its nature is not continuously exercised.[162] For example, the alteration of the dominant land may demonstrate an intention to abandon where the right can no longer be exercised.[163]

McFarlane has suggested that abandonment is better viewed as an application of estoppel.

McFarlane, *The Structure of Property Law* (2008, p 873)

However the concept of abandonment is very problematic. In general, a party with a property right does *not* have the power to simply give up that right: if he wishes to dispose of the right, he needs to transfer it to another. B [the dominant owner] can of course release an Easement; but only if a deed is used. Cases of so-called informal abandonment are hence better seen as examples of: (i) C [the servient owner] having a defence to B's Easement as a result of defensive estoppel; or C [the servient owner] relying on proprietary estoppel to show that B [the dominant owner] is under a duty to release his Easement.

157 See section 2.2 above. 158 See section 2.1.4 above.

159 Shorrock, 'Non-user of Easements' (1998) 4 Nott LJ 26.

160 *Tehidy Minerals Ltd v Norman* [1971] 2 QB 528.

161 The Law Commission has suggested that a presumption of abandonment should arise after twenty years—see Law Comm 327 (2011), [3.230].

162 *Amstrong v Shappard & Shroff* [1959] 2 QB 384; *Benn v Hardinge* (1993) 66 P & CR 246.

163 *Ecclesiastical Commissioners for England v Kino* (1880) 14 Ch D 213; *Williams v Sandy Lane (Chester) Ltd* [2006] EWCA Civ 1738.

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An example of estoppel forming the basis for abandonment is found in *Lester v Woodgate*,[164] where the dominant owner's failure to object to the servient owner's actions in obstructing a right of way formed the basis for an estoppel by acquiescence upon which the servient owner had relied to his detriment such that it was unconscionable for the dominant owner (and his or her successors in title) to continue to assert his or her legal rights to use the right of way.

The Law Commission, meanwhile, has recommended that the jurisdiction of the Lands Chamber of the Upper Tribunal under s 84 of the LPA 1925, which we examine in the next chapter, should be extended to provide for the modification and discharge of easements.[165]

QUESTIONS

1. Do you think that a right to use a swimming pool could exist as an easement?
2. Why has the right to park caused such difficulty in being recognized as an easement?
3. What conceptual challenges do negative easements present?
4. An easement can be impliedly granted either by looking at the future use of the dominant land, or by looking at how the grantor has used the land in the past. In what circumstances can an easement be impliedly reserved?
5. Does it matter whether easements of necessity are based upon public policy or intention?
6. *Wheeldon v Burrows* and s 62 look deceptively similar, but how do they differ?
7. Should prescription be abolished?
8. In what circumstances will an implied or presumed easement vanish upon the sale of the servient land?

FURTHER READING

Bradbrooke, 'Access to Landlocked Land: A Comparative Study of Legal Solutions' (1983–85) 10 Syd LR 39

Burns, 'Easements and Servitudes Created by Implied Grant, Implied Reservation or Prescription and Title by Registration Systems' in *Modern Studies in Property Law: Vol 5* (ed Dixon, Oxford: Hart, 2009)

Burns, 'Prescriptive Easements in England and Legal Climate Change' [2007] Conv 133

Getzler, 'Roman and English Prescription for Incorporeal Property' in *Rationalizing Property, Equity and Trusts: Essays in Honour of Edward Burn* (ed Getzler, London: Butterworths, 2003, ch 11)

Goymour, 'Rights in Property and the Effluxion of Time' in *Modern Studies in Property Law: Vol 4* (ed Cooke, Oxford: Hart, 2007)

Haley and McMurty, 'Identifying an Easement: Exclusive Use, De Facto Control and Judicial Constraints' (2007) 58 NILQ 490

[164] [2010] EWCA Civ 199.

[165] See Law Comm 327 (2011) Part 7.

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Harpum, 'Easements and Centre Point: Old Problems Resolved in a Novel Setting' (1977) 41 Conv 415

Hill Smith, 'Rights of Parking and the Ouster Principle after *Batchelor v Marlow*' [2007] Conv 223

Law Commission Consultation Paper No 186, *Easements, Covenants and Profits à Prendre* (2008)

Law Commission Report No 327 *Making Land Work*: *Easements, Covenants and Profits à Prendre* (2011)

Lawson, 'Easements' in *Land Law: Issues, Debates, Policy* (ed Tee, Devon: Willan, 2002)

Luther, 'Easements and Exclusive Possession' (1996) 16 LS 51

Meager, 'Prescription and User "As of Right": Ripe for Wholesale Reform?' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011)

McClean, 'The Nature of an Easement' (1966) 5 West LR 32

Paton and Seabourne, 'Can't Get There From Here? Permissible Use of Easements After *Das*' [2003] Conv 127

Shorrock, 'Non-user of Easements' (1995) 4 Nott LJ 26

Simpson, '*Wheeldon v Burrows* and the *Code Civile*' [1967] 83 LQR 240

Special Issue on Easements [2012] Conv 1–65

Sturley, 'Easements in Gross' (1980) 96 LQR 557

Tee, 'Metamorphoses and Section 62 of the Law of Property Act 1925' [1998] Conv 115

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26

FREEHOLD COVENANTS

CENTRAL ISSUES

1. Restrictive covenants play an important role in controlling land use, supplementing and complementing public planning laws.
2. A covenant is an agreement by deed and, as such, generally only enforceable between the parties—but restrictive covenants can be enforced by and against subsequent owners of the land to which they relate.
3. A restrictive covenant must: (i) relate to land; (ii) be intended to be enforceable against subsequent owners of the land; (iii) be capable of benefiting adjacent land; and (iv) be negative in nature.
4. To be enforceable as an equitable proprietary interest, a restrictive covenant must be protected by appropriate registration.
5. The benefit of a restrictive covenant will run if it is: (i) expressly assigned; (ii) annexed to the land; or (iii) subject to a building scheme.
6. The breach of a restrictive covenant may result in an award of damages or the court may exercise its discretion to grant an injunction to restrain a breach or order action to 'cure' the breach.
7. The Lands Chamber of the Upper Tribunal has jurisdiction under s 84 of the Law of Property Act 1925 to modify or extinguish restrictive covenants.
8. The law governing covenants has long been regarded as unsatisfactory and has been subject to repeated proposals for reform.

1 INTRODUCTION

A covenant is an agreement entered into by deed and, as such, it binds the parties to the covenant. We saw in Chapter 24 how leasehold covenants may be enforced by and against a landlord's assignee of the freehold reversion and a tenant's assignee of the leasehold estate by privity of estate.[1] In this chapter, we will examine how certain covenants relating to land

[1] See Goulding, 'Privity of Estate and the Enforcement of Real Covenants' (2007) 36 3 CLWR 193 for an interesting view that privity of estate, at one time, extended to covenants affecting the freehold estate and a comparative examination of the US position.

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between freehold owners can overcome the normal privity of contract rule, and can be enforced by and against third parties. For example, where neighbouring freeholders agree with each other that they will not build on their land without the consent of the other, the covenant will be of little value unless it can be enforced not only between the parties to this mutual covenant, but also any person who becomes an owner of either piece of land. Incidentally, the same principles may also be applied to enforce leasehold covenants against parties who are not within privity of estate: for example, subtenants.

1.1 THE ROLE OF LAND COVENANTS

The transformation of land covenants from mere personal contracts between landowners to proprietary obligations that affect subsequent owners of the land occurred during the nineteenth century, when the Chancery courts developed the rules that will be the subject of this chapter.

Gardner explains what prompted these developments.

Gardner, *An Introduction to Land Law* (2009, p 179)

> They date from the first half of the 19th century, a time of rapid growth of English towns. Many inhabitants were poor, but there was also an affluent urban middle class, which aspired to a high standard of living. The prevailing environment of slum housing, factories and so on was inimical to this: even if a middle class family's home was inwardly agreeable, stepping outside the front door could entail a quite different experience. Things could be improved, however, by creating enclaves of middle class housing, producing a more pleasant external as well as internal environment. The techniques by which this was done included the architectural (eg the terrace; and the square was an especially useful way of creating such an enclave especially if the rear rooms of the houses facing the squalor beyond, were made the servants quarters), and the horticultural (eg creating a pleasant garden in the middle of the square, a larger space than each individual house could command, and a place for socialising with persons similarly circumstanced).
>
> But the trick would work only if it was possible to secure the enclave's integrity over time [. . .] This was a task for the law. Restrictive covenants are best understood as the new right in rem developed to perform it.

It was thus a desire to control land use that was the major driver at a time when there was little public health or planning control. Of course, there are now many legal controls over land ownership. Indeed, Gray and Gray[2] describe land ownership as being '*intrinsically delimited by social or community-orientated obligations of a positive nature*'. There are extensive public planning laws and building control regulations, so an owner cannot build on his or her land without the approval of the local planning authority, and other than in a manner that accords with high safety and environmental standards. Conservation of the built and natural environment is promoted through legislative regulation, whilst public health and environmental controls, and the private law of nuisance, provide protection against uses that may endanger quiet and safe enjoyment.

[2] See Gray and Gray, *Elements of Land Law* (5th edn, 2009), [1.5.54]–[1.5.57].

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Despite these measures, privately negotiated land covenants still have a very important role to play. Every estate of new homes is made subject to a range of restrictive covenants to regulate the ambience, and thus maintain the value, of the estate. Land Registry figures estimate that 79 per cent of registered freehold titles are subject to restrictive covenants. In 2003 alone, over 300,000 new covenants were registered over freehold land; only slightly fewer new covenants were created in 2004.[3]

Gray and Gray explain the role that land covenants play.

Gray and Gray, *Elements of Land Law* (4th edn, 2005, [13.20])

> Although public planning processes have now taken over much of the function of privately contracted arrangements, there still remains an important role for private and quasi-private governance of land use. It is often the case that private covenants deal more satisfactorily with the detailed organisation of land use than can existing public planning controls. Private covenants can be particularly significant in regulating the immediate local environment of neighbours as, for instance, where parties contract for the maintenance and repair of boundary features or agree to adhere to a vernacular style of construction or a specific pattern of density in any future development. More generally, however, it is painfully apparent nowadays that privately bargained covenants operate frequently as a longstop guardian of wider, community-orientated conservationist concerns, protecting a range of environmental amenities which are no longer assured by the local planning process.

1.2 THE STRUCTURE AND TERMINOLOGY OF LAND COVENANTS

Before we go on to examine the detailed legal rules that achieve this regulation of land use and amenity, it is important that we understand the structure in which these rules operate and the terminology employed.

As illustrated in Figure 23, A (the owner of Plot A) may agree with his or her neighbour B (the owner of Plot B) that he or she will not build on Plot A without B's consent. Here, A has the *burden* of the covenant: his or her ability to build is restricted and he or she can be sued if he or she builds without consent. A is called the *covenantor*, while B is the *covenantee*. B has the *benefit* of the covenant: he or she can sue if A breaches the covenant.

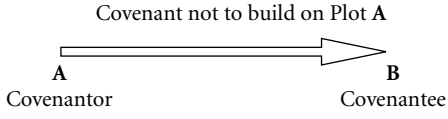

Figure 23 A restricted land covenant

As illustrated in Figure 24, if A sells Plot A, B will need to prove that the burden of A's covenant has passed with Plot A to the new owner. If B, in turn, sells Plot B, his or her purchaser

[3] The figure for 2004 was 268,394: see Law Commission Consultation Paper No 186, *Easements, Covenants and Profits à Prendre* (2008, Appendix A).

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will need to prove that the benefit of the covenant passes with Plot B to the new owner. These processes are referred to as the 'running of' the burden and the benefit.[4] We will use the expression 'dominant land' to refer to the land that has the benefit of the covenant and 'servient land' to refer to the land that is burdened.

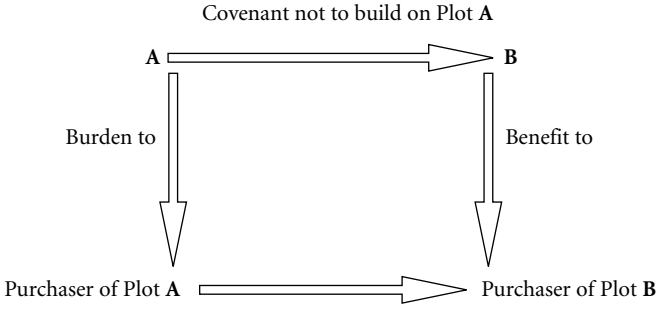

Figure 24 The transmission of the benefit and burden of land covenants

Where the purchasers of Plots A and B acquire, whether by sale or gift, A and B's full freehold title, they are known as the *successors in title* to A and B, but if A leases Plot A and B mortgages Plot B, the new lessee and mortgagee are referred to as *persons deriving title* from A and B, respectively, because the interests that they acquire are carved out of A and B's freehold estates.

As illustrated in Figure 25, the structure becomes a little more complicated in the common situation in which A and B agree with each other that neither of them will build on their land without the consent of the other. Here, the covenants are mutual: A and B have both the benefit and the burden of the covenants; they are each both covenantor and covenantee. To work out, in a given scenario, whether we need to prove whether it is the benefit or the burden that has passed to the current owner of Plots A or B it is easier to ask whom we wish to sue (we need to prove that the burden has run) and then who wishes to sue (he or she must have the benefit of the covenant to do so).

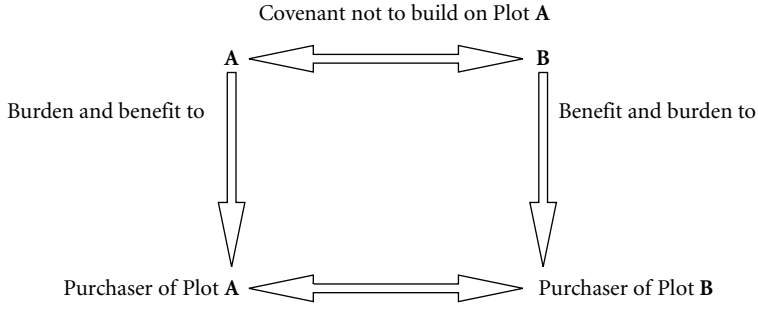

Figure 25 The transmission of mutual land covenants

[4] Gardner has rightly pointed out that it is not the covenant that runs, but the owners of Plots A and B. The benefit and burden of the covenant is attached to the land itself, and thus goes nowhere; it is the owners that change: see Gardner, *Introduction to Land Law* (2009), p 190.

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2 THE BURDEN: WHO CAN SUE?

The burden of a covenant does not run at law,[5] so we must turn to the equitable principles initially formulated in the following leading case.[6]

Tulk v Moxhay
(1848) 2 Ph 774

Facts: In 1808, Tulk sold part of land that he owned in Leicester Square to Elms, who covenanted to Tulk that he would '*at all times thereafter at his own cost keep and maintain the piece of ground in sufficient and proper repair, and in an open state, uncovered with any buildings, in neat and ornamental order*'. This land came into the ownership of Moxhay, who had notice of the covenant that Elms had given to Tulk. When Moxhay made plans to develop the land, Tulk obtained an injunction to restrain him from doing so.

Lord Cottenham LC

At 777

That this Court has jurisdiction to enforce a contract between the owner of land and his neighbour purchasing part of it, that the latter shall either use or abstain from using the land purchased in a particular way, is what I never knew disputed. Here there is no question about the contract: the owner of certain houses in the square sells the land adjoining, with a covenant from the purchaser not to use it for any other purpose than as a square garden. And it is now contended, not that the vendee could violate that contract, but that he might sell the piece of land, and that the purchaser from him may violate it without this Court having any power to interfere. If that were so, it would be impossible for an owner of land to sell part of it without incurring the risk of rendering what he retains worthless. It is said that, the covenant being one which does not run with the land, this Court cannot enforce it; but the question is, not whether the covenant runs with the land, but whether a party shall be permitted to use the land in a manner inconsistent with the contract entered into by his vendor, and with notice of which he purchased. Of course, the price would be affected by the covenant, and nothing could be more inequitable than that the original purchaser should be able to sell the property the next day for a greater price, in consideration of the assignee being allowed to escape from the liability which he had himself undertaken.

That the question does not depend upon whether the covenant runs with the land is evident from this, that if there was a mere agreement and no covenant, this Court would enforce it against a party purchasing with notice of it; for if an equity is attached to the property by the owner, no one purchasing with notice of that equity can stand in a different situation from the party from whom he purchased.

As we saw when examining the decision in Chapter 6, section 2.6, Lord Cottenham's reasoning is primarily based on the fact that Moxhay acquired the land with knowledge of the

[5] *Austerberry v Oldham Corp* (1885) 29 Ch D 750, affirmed in *Rhone v Stephens* [1994] 2 AC 310.

[6] It appears that the principles first emerged in the earlier cases of *Whatman v Gibson* (1839) 2 My & K 517 and *Mann v Stephens* (1846) 15 Sim 377.

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promise that Elms had made to Tulk. On this reasoning, Tulk did not assert a pre-existing equitable interest against Moxhay; rather, Tulk acquired a new, direct right as a result of Moxhay's conduct. But Lord Cottenham also hinted that the initial promise made by Elms to Tulk had proprietary characteristics. Certainly, as the doctrine developed during the latter half of the nineteenth century, the Chancery courts reinterpreted *Tulk v Moxhay* as a case in which Tulk *did* assert a pre-existing equitable interest, arising as a result of Elms' covenant with Tulk. This process is discussed in Chapter 6.[7]

In doing so, those courts also defined the characteristics of that equitable interest more clearly. The rules that they developed may be summarized as follows.

1. The burden of the covenant must not be personal, but must relate to, and be intended to run with, the land to which it relates.
2. There must be dominant land that is capable of benefiting from the covenant.
3. The covenant must be negative in nature.

These characteristics define the content of a land covenant, which, in common with any proprietary interest, must conform to the relevant creation and priority rules if it is to bind the parties and a subsequent purchaser.

2.1 THE COVENANT MUST RELATE TO LAND

The covenant must relate to the land and not to some personal obligation between the parties. A might agree to send B a dozen red roses on Valentine's Day, but whilst that might say something about A's personal attraction to B, it has nothing whatsoever to do with A's ownership of Plot A. The most common covenants that relate to land are concerned with the use of the land, or its repair or maintenance.[8] The parties must also intend that the covenant should affect them as owners of the land, rather than in a solely personal capacity, although such an intention is presumed.

Law of Property Act 1925, s 79(1)

(1) A covenant relating to any land of the covenantor or capable of being bound by him, shall, unless a contrary intention is expressed, be deemed to be made by the covenantor on behalf of himself his successors in title and the persons deriving title under him or them and subject as aforesaid, shall have effect as if such successors and other persons were expressed.

There have been several attempts to argue that s 79 of the Law of Property Act 1925 (LPA 1925) in itself enables the burden to run with the land, but these attempts have failed.[9]

[7] For more detail, see McFarlane [2003] Conv 473, 482–7.

[8] Some covenants prohibiting competition have been held to be personal (see *Morrells of Oxford Ltd v Oxford United Football Club Ltd* [2001] Ch 459), although restricting the user of land to prevent a particular commercial activity may not be (*Newton Abbott Co-operative Society v Williamson & Treadgold Ltd* [1952] 1 Ch 286).

[9] *Re Royal Victoria Pavilion, Ramsgate* [1961] Ch 58; *Tophams Ltd v Earl of Sefton* [1967] 1 AC 50; *Rhone v Stephens* [1994] 2 AC 310; *Morrells of Oxford Ltd v Oxford United Football Club Ltd* [2001] Ch 459; but see Turano, 'Intention, Interpretation and the Mystery of Section 79 of the Law of Property Act 1925' [2000] Conv 377.

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Section 79 is a word-saving device that makes it unnecessary to refer to 'successor in title' and 'persons deriving title' expressly in the covenant itself.

Robert Walker LJ explained (as dicta) its role in the following case, which concerned whether a covenant limiting competition was a personal covenant displaying a contrary intention for the purposes of s 79.

Morrells of Oxford Ltd v Oxford United Football Club Ltd
[2001] Ch 459

Robert Walker LJ

At [40]

Section 79 is concerned with simplifying conveyancing by creating a rebuttable presumption that covenants relating to land of the covenantor are intended to be made on behalf of successors in title, rather than be intended as purely personal. That is a necessary condition, but not a sufficient condition, for making the burden of the covenants run with the land.

A little earlier in his judgment, he explained its effect.[10]

Morrells Oxford Ltd v Oxford United Football Club Ltd
[2001] Ch 459, CA

Robert Walker LJ

At [35]

My tentative view, therefore, coinciding, I think, with the judge's, is that section 79, where it applies, and subject always to any contrary intention, extends the number of persons whose acts or omissions are within the reach of the covenant in the sense of making equitable remedies available, provided that the other conditions for equity's intervention are satisfied. Where [. . .] section 79 applies, its normal effect is not to turn "A covenants with X that A will not build" into "A and B covenant with X that A will not build". Rather it is that "A (on behalf of himself and B) covenants with X that A (or, as the circumstances may require, B) will not build".

2.2 BENEFIT TO DOMINANT LAND

In a similar way to easements, there must be dominant land to which the benefit of the covenant is attached.[11] The benefit is attached to the covenantee's estate in the land[12] and, once he or she has disposed of that estate, he or she cannot enforce the covenant unless, as the original covenantee, he or she has a contractual right to do so. It is thus not possible for a covenant to exist in gross.

[10] See also Hurst, 'The Transmission of Restrictive Covenants' (1982) 2 LS 53, 75.

[11] Some earlier authorities had suggested otherwise: see *Catt v Tourle* (1869) LR 4 Ch 654 and *Luker v Dennis* (1877) 7 Ch D 227.

[12] A landlord's reversion is a sufficient estate for these purposes: see *Hall v Erwin* (1887) 37 Ch D 74.

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A common scenario arises where an owner of land sells part and requires the purchaser to enter into a covenant restricting what he or she can do with the purchased land, to maintain the amenity and value of the land that the seller retains.

London CC v Allen
[1914] 3 KB 642, CA

Facts: In order to obtain permission to form a street on part of his land, Mr Allen entered into a covenant with the London County Council that he would not build on the land at the end of the proposed street so that the new street could be extended. He then sold the land subject to the covenant to his wife, who built on the land. The London County Council tried to enforce the covenant against Mrs Allen, but was unsuccessful because it held no land that could benefit from the covenant.

Buckley LJ

At 654

The reasoning of Lord Cottenham's judgment in *Tulk v. Moxhay* is that if an owner of land sells part of it reserving the rest, and takes from his purchaser a covenant that the purchaser shall use or abstain from using the land purchased in a particular way, that covenant (being one for the protection of the land reserved) is enforceable against a sub-purchaser with notice. The reason given is that, if that were not so, it would be impossible for an owner of land to sell part of it without incurring the risk of rendering what he retains worthless. If the vendor has retained no land which can be protected by the restrictive covenant, the basis of the reasoning of the judgment is swept away. In *Haywood v. Brunswick Permanent Benefit Building Society* the Court of Appeal declined to extend the doctrine of *Tulk v. Moxhay* to covenants other than restrictive covenants. They rejected the doctrine that, inasmuch as the defendants took the land with notice of the covenants, they were bound in equity to perform them. That therefore is not the principle upon which the equitable doctrine rests. In the present case we are asked to extend the doctrine of *Tulk v. Moxhay* so as to affirm that a restrictive covenant can be enforced against a derivative owner taking with notice by a person who never has had or who does not retain any land to be protected by the restrictive covenant in question. In my opinion the doctrine does not extend to that case. The doctrine is that a covenant not running with the land, but being a negative covenant entered into by an owner of land with an adjoining owner, binds the land in equity and is enforceable against a derivative owner taking with notice. The doctrine ceases to be applicable when the person seeking to enforce the covenant against the derivative owner has no land to be protected by the negative covenant. The fact of notice is in that case irrelevant.

The particular equity recognized in *Tulk v. Moxhay* has been said to be analogous to an equitable charge upon land subsisting in the owner of the adjoining land, or to a negative easement enjoyed, not in gross, but by the adjoining land over the land to which the covenant relates. It arises from the possession by the covenantee of land enjoying the benefit of the negative covenant coupled with notice of the existence of the covenant. In *London and South Western Ry. Co. v. Gomm* Sir George Jessel says:

> "The doctrine of *Tulk v. Moxhay,* rightly considered, appears to me to be either an extension in equity of the doctrine of Spencer's Case to another line of cases, or else an extension in equity of the doctrine of negative easements; such, for instance, as a right to the access of light, which prevents the owner of the servient tenement from building so as to obstruct the light. The

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covenant in *Tulk v. Moxhay* was affirmative in its terms, but was held by the Court to imply a negative. Where there is a negative covenant expressed or implied, as, for instance, not to build so as to obstruct a view, or not to use a piece of land otherwise than as a garden, the Court interferes on one or other of the above grounds. This is an equitable doctrine, establishing an exception to the rules of common law which did not treat such a covenant as running with the land, and it does not matter whether it proceeds on analogy to a covenant running with the land or on analogy to an easement."

The situation of the London County Council would not arise today, because statute has granted local authorities (and some other bodies) the ability to enforce covenants in the exercise of certain of their powers, although they hold no dominant land.[13]

Identification of the dominant land

The dominant land needs to be identified with reasonable certainty, although general words, such as the references to the covenantee's retained land, will suffice and it is evident that the courts may look beyond the terms of the conveyance to the surrounding circumstances at the time of the creation of the covenant in order to ascertain the dominant land.[14]

Newton Abbott Co-operative Society v Williamson & Treadgold Ltd
[1952] Ch 286, HC

Facts: Mrs Mardon owned premises known as 'Devonia', on which she carried on business as an ironmonger. She also owned property across the street, which she sold, taking a covenant from the purchaser that he or she would not carry on business as an ironmonger. There was no indication in the covenant that it was taken for the benefit of Devonia. Some years later, the property subject to the covenant came into the ownership of Williamson & Treadgold, who began to sell items of ironmongery and hardware. The Co-op, as the present owner of Devonia and to which the benefit of the covenant had been assigned successfully, obtained an injunction restraining them from doing so.

Upjohn J

At 296

In my judgment, therefore, the problem which I have to consider is this: First, when Mrs. Mardon took the covenant in 1923, did she retain other lands capable of being benefited by the covenant? The answer is plainly yes. Secondly, was such land "ascertainable" or "certain" in this sense that the existence and situation of the land must be indicated in the conveyance or otherwise shown with reasonable certainty?

Apart from the fact that Mrs. Mardon is described as of Devonia, there is nothing in the conveyance of 1923 to define the land for the benefit of which the restrictive covenant was taken, and I do not think that carries one very far; but, for the reasons I have given, I am, in my judgment, entitled to look at the attendant circumstances to see if the land to be benefited is

[13] See (in the cases of local authorities) Housing Act 1985, s 609 considered in *Cantrell v Wycombe DC* [2008] EWCA Civ 866, and (in the case of local planning authorities) Town and Country Planning Act 1990, s 106.

[14] See also *Marten v Flight Refueling Ltd* [1962] 1 Ch 115.

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shown "otherwise" with reasonable certainty. That is a question of fact and, on the admitted facts, bearing in mind the close juxtaposition of Devonia and the defendants' premises, in my view the only reasonable inference to draw from the circumstances at the time of the conveyance of 1923 was that Mrs. Mardon took the covenant restrictive of the user of the defendants' premises for the benefit of her own business of ironmonger and of her property Devonia where at all material times she was carrying on that business, which last-mentioned fact must have been apparent to the purchasers in 1923.

The benefit of the covenant must also accommodate the dominant land of the covenantee, in the sense that it affects '*either the value of the land or the method of its occupation or enjoyment*'.[15] In the *Newton Abbott Case*, the Co-op's counsel unsuccessfully argued that the covenant was a personal anti-competition covenant, which only benefited Mrs Mardon's business and not Devonia.

Newton Abbott Co-operative Society v Williamson & Treadgold Ltd
[1952] Ch 286, HC

Upjohn J

At 292

The second main question was whether the defendants are liable to have the covenant enforced against them. This was Mr. Bowles' main defence in this action and he says that the restrictive covenant was not taken for the benefit of Devonia, and he puts his case in this way: [. . .] he says that in any event this was not taken for the benefit of any land, but was a covenant with Mrs. Mardon personally, solely for the benefit of her business [. . .] Mr. Bowles strongly urged that the covenant was taken solely to protect the goodwill of the business carried on at Devonia, that it had no reference to the land itself, and that it was not taken for the benefit of that land; in brief, that it was a covenant in gross incapable of assignment. He urged that taking such a covenant would benefit the business in that an enhanced price could be obtained for the business, but no such enhanced price would be obtained for the land. He relied on the fact that the covenant did not mention the vendors' assigns and that it was a covenant against competition. Further, he pointed out that when Leonard Soper Mardon assigned to the Bovey Tracey Cooperative Society, the benefit of the covenant was assigned in the deed which assigned the business and not in the lease of Devonia. If that be the right view, then he said there could be no right to enforce the covenant against the defendants because the mere fact that the defendants took with notice is not sufficient to bind their consciences in equity, and he relied on the two cases of *Formby v. Barker* and *London County Council v. Allen*. Those cases show, he submitted, and I agree with him, that in order to enforce a covenant such as this against an assign of the covenantor, you must show that the covenant created something analogous to an equitable easement, that is, you must find something in the nature of a dominant tenement for the benefit of which the covenant was taken and a servient tenement which was to be subject to that covenant. Here he says there was no dominant tenement; the covenant was taken not for the benefit of any land, but for the benefit of the business.

I do not accept this view of the transaction of 1923. In 1923 Mrs. Mardon was carrying on the business of an ironmonger at Devonia. No doubt the covenant was taken for the benefit

[15] *Re Gadds Land Transfer* [1966] Ch 56, 66, *per* Buckley LJ.

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of that business and to prevent competition therewith, but I see no reason to think, and there is nothing in the conveyance of 1923 which leads me to believe, that that was the sole object of taking the covenant. Mrs. Mardon may well have had it in mind that she might want ultimately to sell her land and the business and the benefit of the covenant in such manner as to annex the benefit of the covenant to Devonia for, by so doing, she would get an enhanced price for the totality of the assets which she was selling; a purchaser would surely pay more for a property which would enable him to sue in equity assigns of the defendants' premises taking with notice and to pass on that right, if he so desired, to his successors, than for a property which would only enable him to sue the original covenantor, for that is the result of the view urged on me by Mr. Bowles.

Establishing benefit

Accommodation will normally require reasonable proximity between the servient and dominant land, although it is conceivable that a comparatively large area can benefit where it forms an identifiable unit.[16] There tends to be a presumption of benefit unless such a conclusion just cannot be sustained.[17]

The approach is illustrated and explained in the following case.[18]

Wrotham Park Estate Co Ltd v Parkside Homes Ltd
[1974] 1 WLR 798, HC

Facts: Part of the Wrotham Estate was conveyed subject to a covenant that the land should only be developed in accordance with a layout plan approved by the estate company. Most of the land was developed in accordance with the covenant, but, when Parkside proposed to develop the remaining central area without obtaining prior approval, the estate company successfully took action on the covenant.

Brightman J

At 808

There can be obvious cases where a restrictive covenant clearly is, or clearly is not, of benefit to an estate. Between these two extremes there is inevitably an area where the benefit to the estate is a matter of personal opinion, where responsible and reasonable persons can have divergent views sincerely and reasonably held. In my judgment, in such cases, it is not for the court to pronounce which is the correct view. I think that the court can only decide whether a particular view is one which can reasonably be held.

If a restriction is bargained for at the time of sale with the intention of giving the vendor a protection which he desires for the land he retains, and the restriction is expressed to be imposed for the benefit of the estate so that both sides are apparently accepting that the

[16] See *Marten v Flight Refueling Ltd* [1962] Ch 115 and *Earl of Leicester v Wells-next-the-Sea UDC* [1973] Ch 110, but note the earlier case of *Re Ballard's Conveyance* [1937] Ch 473. Conveyancers usually circumvent any problem by providing for the severance of the covenant between those parts of a large estate that do benefit from the covenant and those parts that do not: see *Marquess of Zetland v Driver* [1939] Ch 1.

[17] It is for the party being sued, i.e. the covenantor or his or her successors in title, to prove the lack of benefit: see *Cryer v Scott Brothers (Sudbury) Ltd* (1988) 55 P & CR 183.

[18] See also *Marten v Flight Refuelling* [1962] Ch 115, 136, *per* Wilberforce J.

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restriction is of value to the retained land, I think that the validity of the restriction should be upheld so long as an estate owner may reasonably take the view that the restriction remains of value to his estate, and that the restriction should not be discarded merely because others may reasonably argue that the restriction is spent.

2.3 NEGATIVITY

The covenant in *Tulk v Moxhay* had both negative and positive aspects: firstly, it called for keeping the land in an open state, i.e. it should not be built upon; and secondly, it called for the maintenance and repair of the land, although it was the negative obligation against building that was enforced.[19] In the later cases of *Hayward v Brunswick Permanent Benefit Building Society*[20] and *London and South West Railway v Gomm*,[21] the court made clear that it would only enforce negative obligations. Negative obligations restrain the owner of the servient land from acting in some way, whilst a positive obligation requires owners to put their hands in their pockets to fund some activity: for example, to maintain the land or repair some building upon it.

There has been growing pressure to enforce positive land covenants, but the judiciary has firmly passed this particular buck to Parliament. In the following case, the House of Lords refused to overcome more than a century of orthodoxy.

Rhone v Stephens
[1994] 2 AC 310, HL

Facts: Walford House was divided into two dwellings—a house and a cottage—in such a way that one of the cottage bedrooms lay under the roof of the house. Upon the sale of the cottage, the owner of the house covenanted with the purchaser to keep the roof in repair. Some years later, when the roof had fallen into disrepair, the owner of the cottage unsuccessfully brought action against the then owner of the house: a successor in title to the original covenantor.

Lord Templeman

At 317

My Lords, equity supplements but does not contradict the common law. When freehold land is conveyed without restriction, the conveyance confers on the purchaser the right to do with the land as he pleases provided that he does not interfere with the rights of others or infringe statutory restrictions. The conveyance may however impose restrictions which, in favour of the covenantee, deprive the purchaser of some of the rights inherent in the ownership of unrestricted land. In *Tulk v. Moxhay* (1848) 2 Ph. 774, a purchaser of land covenanted that no buildings would be erected on Leicester Square. A subsequent purchaser of Leicester Square was restrained from building. The conveyance to the original purchaser deprived him

[19] In *Morland v Cook* (1868) LR 6 Eq 252 and *Cooke v Chilcott* (1876) 3 Ch D 694, positive obligations were enforced. See Bell, '*Tulk v Moxhay* Revisited' [1981] Conv 55; Griffiths, '*Tulk v Moxhay* Reclarified' [1983] Conv 29.

[20] (1881) 8 QBD 403. [21] (1882) 20 Ch D 562.

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and every subsequent purchaser taking with notice of the covenant of the right, otherwise part and parcel of the freehold, to develop the square by the construction of buildings. Equity does not contradict the common law by enforcing a restrictive covenant against a successor in title of the covenantor but prevents the successor from exercising a right which he never acquired. Equity did not allow the owner of Leicester Square to build because the owner never acquired the right to build without the consent of the persons (if any) from time to time entitled to the benefit of the covenant against building [. . .] Equity can thus prevent or punish the breach of a negative covenant which restricts the user of land or the exercise of other rights in connection with land. Restrictive covenants deprive an owner of a right which he could otherwise exercise. Equity cannot compel an owner to comply with a positive covenant entered into by his predecessors in title without flatly contradicting the common law rule that a person cannot be made liable upon a contract unless he was a party to it. Enforcement of a positive covenant lies in contract; a positive covenant compels an owner to exercise his rights. Enforcement of a negative covenant lies in property; a negative covenant deprives the owner of a right over property. As Lord Cottenham L.C. said in *Tulk v. Moxhay,* at p. 778: 'if an equity is attached to the property by the owner, no one purchasing with notice of that equity can stand in a different situation from the party from whom he purchased.'

Following *Tulk v. Moxhay* there was some suggestion that any covenant affecting land was enforceable in equity provided that the owner of the land had notice of the covenant prior to his purchase.

[His Lordship then considered the authorities: namely, the cases of *Morland v Cook*,[22] *Cooke v Chilcott*,[23] *Haywood v Brunswick Permanent Benefit Building Society,*[24] and *London and South Western Railway Co v Gomm.*[25]]

At 321

For over 100 years it has been clear and accepted law that equity will enforce negative covenants against freehold land but has no power to enforce positive covenants against successors in title of the land. To enforce a positive covenant would be to enforce a personal obligation against a person who has not covenanted. To enforce negative covenants is only to treat the land as subject to a restriction.

[His Lordship then referred to academic criticism of the rule and to recommendations by the Law Commission to alter the law.]

In these circumstances your Lordships were invited to overrule the decision of the Court of Appeal in the *Austerberry case.* To do so would destroy the distinction between law and equity and to convert the rule of equity into a rule of notice. It is plain from the articles, reports and papers to which we were referred that judicial legislation to overrule the *Austerberry case* would create a number of difficulties, anomalies and uncertainties and affect the rights and liabilities of people who have for over 100 years bought and sold land in the knowledge, imparted at an elementary stage to every student of the law of real property, that positive covenants, affecting freehold land are not directly enforceable except against the original covenantor. Parliamentary legislation to deal with the decision in the *Austerberry case* would require careful consideration of the consequences. Moreover, experience with leasehold tenure where positive covenants are enforceable by virtue of privity of estate has demonstrated that social injustice can be caused by logic.

[22] (1868) LR 6 Eq 252. [23] (1876) 3 Ch D 694. [24] (1881) 8 QBD 403.
[25] (1882) 20 Ch D 562.

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Lord Templeman argues that where land is burdened by a negative covenant, the purchaser never receives the ability to act in breach of that covenant. Where the covenant is positive, however, he argues that the purchaser's title is burdened with an additional obligation that equity cannot order should be performed without contradicting the common law. O'Connor explains the distinction:

O'Connor, 'Careful what you wish for: positive freehold covenants' [2011] Conv 191

A restrictive covenant removes one or more use rights from the burdened owner's bundle of use rights, making it inequitable for a purchaser with notice to assert a use right which he or she did not acquire. Positive obligations to other landowners never formed part of the bundle in the first place. They can only be added by contract, and they bind only those who have agreed to undertaken them.

Gardner comments that Lord Templeman's reasoning is not convincing; rather, the decision springs from an understandable reluctance to entertain judicial legislation.

Gardner, 'Two Maxims of Equity' (1995) 54 CLJ 60, 67

He appears to suppose that the common law, with its privity rule, "objects" to covenants being enforced against purchaser, but is "content" for them to bind purchasers under nemo dat, if some other system—equity—wants to make them do so.

But this analysis is surely chimerical. We simply do not know whether the common law "objects" to covenants being enforced against non-parties, either as such or by virtue of nemo dat; or whether it is "content" for this to happen; or whether indeed, it aches for it to happen. And the reason we do not know is, of course, that the common law cannot possess such states of mind or emotions. That is not quite to say that Lord Templeman's version of the proposition is unworkable, however. It can be made workable if the judges are prepared to make the attitude of the common law the subject of oracular pronouncement, as though it were a mystery of which they were the priests. This is in effect how Lord Templeman proceeds when he tells us that to make positive covenants binding on purchasers would "contradict", rather than "supplement", the common law. But when we understand that the proposition must operate, if at all, in this way, we cannot but find it a quite remarkably indeterminate and opaque tool of reasoning, outstripping in these respects even the established maxims. Its acceptability in the law must therefore be in extreme doubt.

In *Rhone v Stephens*, the considerations which resort to the proposition concealed were essentially as follows. Whilst it is widely felt that to provide for the running of positive covenants is desirable, the reform is an unsuitable one for judicial legislation, for two reasons. First it would need to be accompanied by a good deal of fine print, which could only be supplied by statute. Secondly, a judicial decision to enforce positive covenants would necessarily operate retrospectively, which would defeat the legitimate expectation of purchasers, advised on the basis of existing law, that they take free of such covenants.

The Law Commission has again looked at the question and we will be considering its proposals in section 5 below. In the meantime, there are a number of mechanisms that conveyancers use to try to enforce positive covenants.

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2.4 INDIRECT ENFORCEMENT OF POSITIVE COVENANTS

The inability to directly enforce positive freehold covenants against subsequent purchasers of the servient land causes inconvenience and conveyancers have needed to be inventive. The need to enforce positive obligations is particularly acute where properties share facilities when provision needs to be made for their upkeep and repair. We have already seen, in Chapter 24, that the same problem does not affect positive leasehold covenants and, in the next chapter, we will examine the mechanisms employed to address the repair and maintenance of shared facilities in flat ownership. For now, we will consider the other devices that have been employed.

2.4.1 Mutual benefit and burden

The principle of mutual benefit and burden is encapsulated in the maxim that 'he who takes the benefit of a right must bear the burden upon which it is dependent'. As we noted in Chapter 6, section 2.5, if A enters into a positive covenant with B, the principle may sometimes impose a duty on C, a party later acquiring A's land, to perform that positive covenant. The principle is illustrated by the case of *Halsall v Brizell*,[26] in which purchasers of houses on an estate in Liverpool were granted a right to use the estate roads, the drains, the promenade, and the sea wall, subject to an obligation to contribute to the repair and upkeep of these facilities. When Brizell, a successor in title to one of the original purchasers, questioned his contribution, the court held that he could not claim the benefit of the right to use these facilities without accepting the attendant obligation to pay for their upkeep.

In *Tito v Wadell (No 2)*,[27] Megarry V-C drew a distinction between *conditional benefits*, in which the benefit was conferred subject to a condition that a burden be accepted, and *independent obligations*, in which the right and obligation, although granted by the same instrument, were not interdependent. In the case of conditional benefits, the burden clearly passes, because the obligation is an intrinsic part of the right. In the case of independent obligations, Megarry V-C argued that the burden should also pass, under what he called the 'pure benefit and burden' principle, where the construction of the instrument demonstrated that a successor in title was not intended to take the benefit without also accepting the burden. In other words, although the initial grant was not conditional upon the burden, its subsequent assignment was. The principle of pure benefit and burden, taken to its logical conclusion, could have circumvented the common laws' prohibition on the burden of covenants passing, but the House of Lords has rejected the principle.

Rhone v Stephens
[1994] 2 AC 310, HL

Lord Templeman

At 322

Mr. Munby also sought to persuade your Lordships that the effect of the decision in the *Austerberry case* had been blunted by the 'pure principle of benefit and burden' distilled by Sir Robert Megarry V.-C. from the authorities in *Tito v. Waddell (No. 2)* [1977] 1 Ch. 106, 301 et seq. I am not prepared to recognise the 'pure principle' that any party deriving any benefit

[26] [1957] Ch 169. [27] [1977] 1 Ch 106.

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from a conveyance must accept any burden in the same conveyance. Sir Robert Megarry V.-C. relied on the decision of Upjohn J. in *Halsall v. Brizell* [1957] Ch. 169. In that case the defendant's predecessor in title had been granted the right to use the estate roads and sewers and had covenanted to pay a due proportion for the maintenance of these facilities. It was held that the defendant could not exercise the rights without paying his costs of ensuring that they could be exercised. Conditions can be attached to the exercise of a power in express terms or by implication. *Halsall v. Brizell* was just such a case and I have no difficulty in wholeheartedly agreeing with the decision. It does not follow that any condition can be rendered enforceable by attaching it to a right nor does it follow that every burden imposed by a conveyance may be enforced by depriving the covenantor's successor in title of every benefit which he enjoyed thereunder. The condition must be relevant to the exercise of the right. In *Halsall v. Brizell* there were reciprocal benefits and burdens enjoyed by the users of the roads and sewers. In the present case clause 2 of the 1960 conveyance imposes reciprocal benefits and burdens of support but clause 3 which imposed an obligation to repair the roof is an independent provision. In *Halsall v. Brizell* the defendant could, at least in theory, choose between enjoying the right and paying his proportion of the cost or alternatively giving up the right and saving his money.

The Court of Appeal has subsequently formulated a two-stage test to establish whether a covenant falls within the mutual benefit and burden principle. The first stage looks to proof that the benefit is conferred conditionally upon performance of the burden; the second stage calls for the successor in title to have a choice as to whether he or she will accept the benefit and its attendant burden.

Thamesmead Town Ltd v Allotey
(2000) 79 P & CR 557, CA

Facts: A tenant on the Thamesmead Estate purchased the freehold reversion of his house under a right to buy. In the conveyance, he entered into a covenant to contribute to the upkeep of the roads, footpaths, sewers, and cables, as well as the landscaped and communal areas. The conveyance included a right for the purchaser to use the roads, footpaths, sewers, and cables, but no right to use the landscaped or communal areas. The tenant sold his house and his purchaser, Mr Allotey, questioned the amount of the service charge that he was required to pay. The Court held that he was not liable to pay that proportion of the charge which related to the costs of the landscaped and communal areas, because he had not been granted a right to use these facilities.

Peter Gibson LJ

At 564

The reasoning of Lord Templeman suggests that there are two requirements for the enforceability of a positive covenant against a successor in title to the covenantor. The first is that the condition of discharging the burden must be relevant to the exercise of the rights which enable the benefit to be obtained. In *Rhone v. Stephens* the mutual obligations of support was unrelated to, and independent of, the covenant to maintain the roof. The second is that the successors in title must have the opportunity to choose whether to take the benefit or having taken it to renounce it, even if only in theory, and thereby to escape the burden and that the successors in title can be deprived of the benefit if they fail to assume the burden.

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On both those grounds *Halsall v. Brizell* was distinguished. Although Lord Templeman expressed his wholehearted agreement with Upjohn J.'s decision, Lord Templeman's description of that decision was limited to the defendant being unable to exercise the rights to use the estate roads and to use the sewers without paying his costs of ensuring that they could be exercised. Nothing was expressly said about the cost of maintaining the sea wall or promenade and it is a little difficult to see how, consistently with Lord Templeman's reasoning and, in particular, the second requirement for the enforceability of a positive covenant, the cost of maintaining the sea wall would fall within the relevant principle [. . .]

Lord Templeman was plainly seeking to restrict, not enlarge, the scope of the exception from the rule that positive covenants affecting freehold land are not directly enforceable except against the original covenantor. Lord Templeman treated *Halsall v. Brizell* as a case where the right to use the estate roads and sewers was conditional on a payment of a due proportion of the maintenance expenses for those facilities. Whilst agreeing with the decision, Lord Templeman made clear that for a burden to be enforceable it must be relevant to the benefit. He said that simply to attach a right to a condition for payment would not render that condition enforceable. Similarly, it is not possible to enforce every burden in a conveyance by depriving the covenantor's successors in title of every benefit which he enjoyed under the conveyance. There must be a correlation between the burden and the benefit which the successor has chosen to take. Lord Templeman plainly rejected the notion that taking a benefit under a conveyance was sufficient to make every burden of the conveyance enforceable. Further, there is no authority to suggest that any benefit obtained by a successor in title, once the property has been transferred to him, to enable the enforcement of a burden under the conveyance is sufficient, even if that benefit was not conferred as of right by the conveyance. In my judgment, it cannot be sufficient that the taking of an incidental benefit should enable the enforcement of a burden against a person who has not himself covenanted to undertake the particular burden.

2.4.2 Chain of indemnity covenants

It is common practice for conveyancers to build up a chain of personal covenants between successors in title of the covenantor, to try to ensure that contractual liability may be passed down from the original covenantor to the current owner of the servient land. If the current owner breaches a positive covenant, the covenantee can sue the original covenantor, who, in turn, can sue his or her direct successor in title on his or her personal covenant—and so on down the chain of covenants, until liability comes to rest upon culprit. The mechanism provides an unsatisfactory solution, both because the covenantee may only recover damages in respect of the breach, rather than an injunction, and because the chain may easily be broken by the disappearance or insolvency of one of the links.

2.4.3 Estate rentcharges

The expenses incurred in maintaining and repairing common facilities within an estate may be recoverable by imposing an estate 'rentcharge' on the land.[28] An estate rentcharge is a legal interest that requires the owner of the burdened land to pay a periodic sum, which may be recovered by exercising an attached right of re-entry.[29] That sum may be nominal,

[28] Whilst new rent charges cannot generally be created following the Rentcharges Act 1977, estate rent charges are exempt from this prohibition: see Rentcharges Act 1977, ss 2(1), (2), and (3)(c).

[29] Bright, 'Estate Rentcharges and the Enforcement of Positive Obligations' [1988] Conv 99.

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where the estate rentcharge is used as a device to enforce positive covenants, or may reflect the cost incurred by the holder of the rentcharge (i.e. the developer or manager, as owner of the estates' common parts) of '*meeting or contributing towards the cost of performance* [...] *of covenants for the provision of services, carrying out maintenance or repairs, effecting insurance or the making of any benefit*'.[30]

2.5 THE ACQUISITION AND PRIORITY OF RESTRICTIVE COVENANTS

2.5.1 Creation of covenants

Covenants are invariably expressly created by deed—usually in the conveyance, when part of land is sold off—and are made pursuant to the contract for the sale of that land.[31] Because restrictive covenants operate in equity rather than at law, however, it is theoretically possible for a restrictive covenant to be created by signed writing[32] or even through the operation of proprietary estoppel.[33]

2.5.2 The priority of covenants

The decision of Lord Cottenham in *Tulk v Moxhay* was based upon the unconscionability that would result if purchasers with notice of the covenant could then claim that they were not bound. Indeed, purchasers could be unjustly enriched if the land, freed from the burden covenant, were then to increase in value. As the doctrine developed, the courts came to recognize restrictive covenants as equitable proprietary interests, which would bind all save for a bona fide purchaser of the legal estate without notice of the covenant. This metamorphosis of restrictive covenants from personal obligation to proprietary status was a remarkable development. It is not surprising that the courts then had to work hard to keep the doctrine within clear definitional bounds, to maintain a balance between the amenity advantages of restrictive covenants and the danger of sterilizing land development by '*incidents of a novel kind* [...] *devised* [...] *at the fancy and caprice of any owner*'.[34]

The proprietary status of restrictive covenants is explained in the following case, in which the question before the court was whether a squatter took subject to restrictive covenants affecting the title that had been extinguished.

Re Nisbet & Potts Contract
[1906] 1 Ch 386, CA

Collins MR

At 402

It seems to me, therefore, that the principal question before us is whether or not Sir George Jessel was right in the view that he took in *London and South Western Ry. Co. v. Gomm*, that an obligation created by a restrictive covenant is in the nature of a negative easement, creating

[30] Rentcharges Act 1977, s 2(4)(b) and (5).
[31] Theoretically, a covenant might be implied as a result of the usual contractual principles governing the implication of terms.
[32] See Law of Property Act 1925, s 53(1)(a).
[33] See Chapter 10.
[34] *Keppel v Bailey* (1834) 2 My & K 517, 535, *per* Lord Brougham.

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> a paramount right in the person entitled to it over the land to which it relates. If that is so, then, in the present case, the squatter, by his squatting, simply acquired a right to land subject to this incident. Of course, the burden of that incident must pass to all persons who subsequently become assignees of the land, and the squatter is not entitled to hand it over freed from the obligation that was imposed on the person whose title he has ousted by his possession.
>
> Now, is that the law or not? In the first place, I do not think there was anything inconsistent in the view taken by Sir George Jessel with the law as laid down in the leading case of *Tulk v. Moxhay*, though, no doubt, words are used there pointing to the equity arising out of the injustice which would accrue if a person who had acquired land at a reduced price by reason of its user being subject to a restriction were afterwards enabled to pass on that land to other persons freed from that restriction receiving in return, on that ground, an increased price. That element, no doubt, does enter into consideration, when one comes to inquire what is the position of a person who acquires for value the legal estate in land subject to a right that has previously been created in another person to restrict the user of that land. The right so created is an equitable right, and, therefore, it is one capable of being defeated in certain circumstances by a person who acquires the legal estate for value. The question thus arises whether, in the circumstances of the particular case, there is anything which would make it inequitable for that person to avail himself of his legal estate to defeat that equitable right. That, as Mr. Upjohn pointed out, is an inquiry which is inevitable in cases where you are dealing with equitable rights and legal estates. But that does not in the least prevent the right in question being what Sir George Jessel considered it to be, namely, a burden imposed upon the land, and passing with the land, subject, of course, to this, that it may be defeated by a purchaser for value without notice; but the burden is upon the person who takes the land to shew that he has acquired it under such conditions as to defeat the right as against him, namely, that he has acquired it for value and without notice.

The priority of restrictive covenants created before 1925 continues to be regulated by notice, but restrictive covenants created after 1925 have been assimilated into the relevant registration regime. Where the servient land is unregistered, a restrictive covenant must be registered as a Class D(iii) land charge,[35] whilst where the servient land is registered, the covenant must be protected by the entry of a notice on the charges register.[36]

3 THE BENEFIT: WHO CAN SUE?

Those entitled to the benefit of a land covenant defines those who can take action on the covenant. There are three ways in which the benefit of a covenant can pass from the original covenantee to a new owner of the dominant land:

- by assignment, both at law and in equity;
- by annexation of the benefit of the covenant to the land, either by express words, implication, or by the operation of s 78 of the LPA 1925; or
- under a building scheme.

These three methods, particularly annexation, have been the subject of highly technical rules that have been described as providing '*one of the richest areas of fantasy in printed English*'.[37]

[35] See Chapter 13; Land Charges Act 1925, s 101; Land Charges Act 1972, s 2(5).
[36] See Chapter 14; Land Registration Act 2002, ss 29, 32–34.
[37] Kenny, 'Conveyancer's Notebook' [2006] Conv 1, 2.

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The search has been to find both an intention that the benefit of the covenant should pass and also to identify, with a degree of certainty, the land to which the benefit is attached.

Wade explains the tensions that have resulted.

Wade, 'Covenants: "A Broad and Reasonable View" ' (1972) 31 CLJ 157, 162–5

After making much heavy weather over the transmission of the benefit, and so producing a body of law of notorious and unnecessary difficulty, the Chancery judges have now for twenty years been striving to relax their own rules. They have been working towards what might be called implied annexation, where there is no requirement of any formality but the decisive factor is the intention of the parties to the covenant, as inferred not only from its language but also from the surrounding facts at the time when it was made. The tendency is thus to assimilate the law of covenants to the law of easements, where no formalities are required for establishing the rights as appurtenant to the dominant tenement.

This policy is uncomfortable to conveyancers, who inhabit a world of paper and ink in which all important facts are expected to be clearly stated in documents of title [. . .]

Accordingly there may be said to be two opposing views: the "conveyancers' view," if it may be so called advocates compulsory formality; and the "judicial view" which at present indicates away from formality, and which at all times is concerned to temper the injustice which compulsory formality entails [. . .]

The question is very much one of degree. No one complains that it is excessively strict to require that freehold land should be conveyed by deed. But the law of restrictive covenants is at present being judicially purged of an overdose of formalism.

Many of the decisions have been excessively technical, and at times the courts seem bemused by their own refinements. But this is because they have been pressed with the subtle arguments prompted by the "conveyancers' view" that the benefited land should be clearly defined in the deed of covenant. Occasionally they have appeared to accept this, and judges and others have slipped into saying that the deed must identify the land. But in general they have resisted it.

3.1 ASSIGNMENT

Like the benefit of any other contract, the benefit of a land covenant may be assigned. Thus the original covenantee may transfer both the land and the benefit of the covenant to a purchaser of the land by using express words of assignment, provided that the covenant relates to the land, in the sense that it is not personal to the covenantee. The benefit of the covenant will need to be expressly assigned on each disposal of the land to build up a continuous chain of assignments. The assignment may take effect at law where the original covenantee and his or her assignee hold a legal estate in the land, although that need not be the same legal estate.[38]

Assignment at law is, however, of limited value: only the original convenator can be sued, given that the burden does not run at law, and, because a covenant cannot be severed at law, a legal assignment will not assist where part of the dominant land is sold.

Assignment in equity, the requirements of which are found in the following case, overcomes these deficiencies and is frequently employed by conveyancers.

[38] *Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board* [1949] 2 KB 500.

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Miles v Easter
[1933] Ch 611, CA

Romer LJ

At 631

It is plain, however, from these and other cases, and notably that of *Renals v. Cowlishaw,* that if the restrictive covenant be taken not merely for some personal purpose or object of the vendor, but for the benefit of some other land of his in the sense that it would enable him to dispose of that land to greater advantage, the covenant, though not annexed to such land so as to run with any part of it, may be enforced against an assignee of the covenantor taking with notice, both by the covenantee and by persons to whom the benefit of such covenant has been assigned, subject however to certain conditions. In the first place, the "other land" must be land that is capable of being benefited by the covenant—otherwise it would be impossible to infer that the object of the covenant was to enable the vendor to dispose of his land to greater advantage. In the next place, this land must be "ascertainable" or "certain," to use the words of Romer and Scrutton L.JJ. respectively. For, although the Court will readily infer the intention to benefit the other land of the vendor where the existence and situation of such land are indicated in the conveyance or have been otherwise shown with reasonable certainty, it is impossible to do so from vague references in the conveyance or in other documents laid before the Court as to the existence of other lands of the vendor, the extent and situation of which are undefined. In the third place, the covenant cannot be enforced by the covenantee against an assign of the purchaser after the covenantee has parted with the whole of his land.

3.2 ANNEXATION

Annexation is a once-and-for-all process by which the benefit of the covenant is glued to the land, so as to become part of the land and thus pass automatically upon a conveyance of the land. Two concerns need to be met to ensure annexation: firstly, there must be an intention that the benefit of the covenant should become part of the land; and secondly, it is necessary to determine the physical limits of the land to which the covenant is annexed—that is, what area is covered by the annexing glue? These questions are the flip side of the requirement for accommodation that we examined in section 2.2.

It is in the clarity of the evidence required to prove these two elements that the tension between the 'conveyancers' view' and the 'judicial view' is most evident. Conveyancers have looked to express words of annexation contained in the covenant and to clear evidence of the physical definition of the land in the conveyancing documents, whilst the courts have accepted a lower standard of evidence.

3.2.1 Express annexation

Express words of annexation can be demonstrated by contrasting the wording of the covenants in *Rogers v Hosegood*[39] and that in *Renals v Cowlishaw.*[40]

[39] [1900] 2 Ch 388. [40] (1878) 8 Ch D 125.

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In *Rogers v Hosegood*, a covenant was made in the following terms.

> With the intent that the covenant might as far as possible bind the premises [. . .] conveyed and every part thereof, into whosoever hands the same might come, and might enure to the benefit of the mortgagees, their heirs and assigns and others claiming under them to all or any of their lands adjoining or near the premises.

In *Renals v Cowlishaw*, the covenants merely stated that it was taken for '*the vendors, their heirs, executors, administrators and assigns*'.

Thus, in *Rogers v Hosegood*, it was clear that the covenant was to become part of the land, because it was made with the covenantee and his or her successors in title in their capacity as owners of adjoining land; in *Renals v Cowlishaw*, the absence of any reference to the covenantee's land was fatal.

The technicality of express annexation and its relationship with the passing of the burden is illustrated by the following judgment of Farwell J.

Marquess of Zetland v Driver
[1939] Ch 1, CA

Facts: A conveyance of a shop in Redcar made by the Marquess' estate contained a covenant by the purchaser not to commit any nuisance to the vendor or occupiers of any adjoining property in the neighbourhood. The covenant was expressed to be made for the benefit of such parts of the Marquess' estate as should remain unsold or be sold with the benefit of the covenant. An injunction was granted to restrain the use of the shop for the sale of fish and chips.

Farwell J

At 8

[. . .] [C]ovenants can only be validly imposed if they comply with certain conditions. Firstly, they must be negative covenants. No affirmative covenant requiring the expenditure of money or the doing of some act can ever be made to run with the land. Secondly, the covenant must be one that touches or concerns the land, by which is meant that it must be imposed for the benefit or to enhance the value of the land retained by the vendor or some part of it, and no such covenant can ever be imposed if the sale comprises the whole of the vendor's land. Further, the land retained by the vendor must be such as to be capable of being benefited by the covenant at the time when it is imposed. Thirdly, the land which is intended to be benefited must be so defined as to be easily ascertainable, and the fact that the covenant is imposed for the benefit of that particular land should be stated in the conveyance and the persons or the class of persons entitled to enforce it. The fact that the benefit of the covenant is not intended to pass to all persons into whose hands the unsold land may come is not objectionable so long as the class of persons intended to have the benefit of the covenant is clearly defined. Finally, it must be remembered that these covenants can only be enforced so long as the covenantee or his successor in title retains some part of the land for the benefit of which the covenant was imposed. Applying those conditions to the present case, the covenant sued upon appears to comply with them [. . .]

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> Under those circumstances, there does not appear to be any ground on which the appellant can properly be refused the relief which he seeks; but Bennett J. took the opposite view and held that the benefit of the covenant had not passed to the appellant. In coming to that conclusion he founded himself upon a decision of Clauson J. in *re Ballard's Conveyance*, which he considered to be exactly in point and binding upon him. In our judgment the learned judge was wrong in thinking that *In re Ballard's Conveyance* was an authority in this case. It is not necessary for us, and we do not propose, to express any opinion as to that decision beyond saying that it is clearly distinguishable from the present case, if only on the ground that in that case the covenant was expressed to run with the whole estate, whereas in the present case no such difficulty arises because the covenant is expressed to be for the benefit of the whole or any part or parts of the unsold settled property.

There is some support for the view that proof of annexation may also be gleaned from the circumstances surrounding the making of the conveyance: for example, where those circumstances demonstrate to which land the benefit is to be annexed.[41]

In the above extract, Farwell distinguished *Re Ballards Conveyance*,[42] in which annexation failed because the dominant land was so large that it was impossible to prove that the entire area benefited.[43] Whilst part of the land clearly could benefit, the court refused to sever the covenant so that the benefit could at least pass with that part. This unfortunate result was avoided in *Marquess of Zetland v Driver*, in which the covenant was expressed to be annexed to '*each and every part of the estate*'.

Brightman LJ doubted the need for these words in the following case.

Federated Homes Ltd v Mill Lodge Properties Ltd
[1980] 1 WLR 594, CA

Brightman LJ

At 606

> [. . .] [T]he idea of annexation of a covenant to the whole of the land but not to part of it is a difficult conception to grasp [. . .] I would have thought, if a covenant is, on a proper construction of a document, annexed to the land, prima facie it is annexed to every part thereof, unless the contrary clearly appears.

His views have subsequently been followed at first instance in *Small v Oliver & Saunders*.[44]

3.2.2 Statutory annexation

The technicalities of express annexation have been sidestepped by judicial recognition that s 78 of the LPA 1925 provides automatic annexation in respect of covenants entered into after 1925.[45]

[41] See *Rogers v Hosegood* [1900] 2 Ch 388, 408, and *Marten v Flight Refueling Ltd* [1962] Ch 115, 133.
[42] [1937] Ch 473. [43] The area was a 1,700-acre estate. [44] [2006] EWHC 1293, [29].
[45] Express annexation continues to be necessary under Conveyancing and Law of Property Act 1881, s 58, where the covenant is entered into before 1925: see *J Sainsbury plc v Enfield LBC* [1989] 1 WLR 590, *Southwark Roman Catholic Diocesan Corp v South London Church Fund and Southwark Diocesan Board of Finance* [2009] EWHC 3368 and *Seymour Road (Southampton) Ltd v Williams* [2010] EWHC 111.

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Law of Property Act 1925, s 78

(1) A covenant relating to any land of the covenantee shall be deemed to be made with the covenantee and his successors in title and the persons deriving title under him or them, and shall have effect as if such successors and other persons were expressed.

For the purposes of this subsection in connection with covenants restrictive of the user of land 'successors in title' shall be deemed to include the owners and occupiers for the time being of the land of the covenantee intended to be benefited.

(2) This section applies to covenants made after the commencement of this Act, but the repeal of section fifty eight of the Conveyancing Act 1881 does not affect the operation of covenants to which that section applied.

The Court of Appeal considered the effect of this section in the following case.

Federated Home Ltd v Mill Lodge Properties Ltd
[1980] 1 WLR 594, CA

Facts: A vendor sold an area of land for development ('the blue land') to Mill Lodge, subject to a covenant restricting the density of development so as not to prejudice development of the vendor's retained land under an existing planning permission. Subsequently, two further areas of land ('the red land' and 'the green land') were sold by the vendor and came into the ownership of Federated Homes. Mill Lodge threatened to breach the covenant and Federated Homes successfully sought an injunction claiming the benefit of the covenant. There was no express annexation conferring the benefit of the covenant upon the red and green land, although there was an express assignment of the benefit of the covenant in respect of the green land.

Brightman LJ

At 604

Mr. Price submitted that there were three possible views about section 78. One view, which he described as "the orthodox view" hitherto held, is that it is merely a statutory shorthand for reducing the length of legal documents. A second view, which was the one that Mr. Price was inclined to place in the forefront of his argument, is that the section only applies, or at any rate only achieves annexation, when the land intended to be benefited is signified in the document by express words or necessary implication as the intended beneficiary of the covenant. A third view is that the section applies if the covenant in fact touches and concerns the land of the covenantee, whether that be gleaned from the document itself or from evidence outside the document.

For myself, I reject the narrowest interpretation of section 78, the supposed orthodox view, which seems to me to fly in the face of the wording of the section. Before I express my reasons I will say that I do not find it necessary to choose between the second and third views because, in my opinion, this covenant relates to land of the covenantee on either interpretation of section 78. Clause 5 (iv) shows clearly that the covenant is for the protection of the retained land and that land is described in clause 2 as "any adjoining or adjacent property retained by the vendor." This formulation is sufficient for annexation purposes: see *Rogers v. Hosegood* [1900] 2 Ch. 388.

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There is in my judgment no doubt that this covenant "related to the land of the covenantee," or, to use the old-fashioned expression, that it touched and concerned the land, even if Mr. Price is correct in his submission that the document must show an intention to benefit identified land. The result of such application is that one must read clause 5 (iv) as if it were written: "The purchaser hereby covenants with the vendor and its successors in title and the persons deriving title under it or them, including the owners and occupiers for the time being of the retained land, that in carrying out the development of the blue land the purchaser shall not build at a greater density than a total 300 dwellings so as not to reduce, etc." I leave out of consideration section 79 as unnecessary to be considered in this context, since Mill Lodge is the original covenantor.

The first point to notice about section 78 (1) is that the wording is significantly different from the wording of its predecessor section 58 (1) of the Conveyancing Act 1881. The distinction is underlined by section 78 (2), which applies section 78 (1) only to covenants made after the commencement of the Act. Section 58 (1) of the Act of 1881 did not include the covenantee's successors in title or persons deriving title under him or them, or the owner or occupiers for the time being of the land of the covenantee intended to be benefited. The section was confined, in relation to realty, to the covenantee, his heirs and assigns, words which suggest a more limited scope of operation than is found in section 78.

If, as the language of section 78 implies, a covenant relating to land which is restrictive of the user thereof is enforceable at the suit of (1) a successor in title of the covenantee, (2) a person deriving title under the covenantee or under his successors in title, and (3) the owner or occupier of the land intended to be benefited by the covenant, it must, in my view, follow that the covenant runs with the land, because ex hypothesi every successor in title to the land, every derivative proprietor of the land and every other owner and occupier has a right by statute to the covenant. In other words, if the condition precedent of section 78 is satisfied—that is to say, there exists a covenant which touches and concerns the land of the covenantee—that covenant runs with the land for the benefit of his successors in title, persons deriving title under him or them and other owners and occupiers.

The decision was controversial and has been criticized by those taking the traditional 'conveyancers' view'.[46] Two particular objections have been raised. The first, it is argued, is that this interpretation of s 78 is at odds with the interpretation given to its sister provision concerning the running of the burden found in s 79.[47] But the wording of the two sections is different, as Snape explains.

Snape, 'The Benefit and Burden of Covenants: now where are we?'
(1994) 68 Nott LJ 68, 71

The crucial difference between the two sections is that, whilst section 78 [...] deems the covenant to be made "with the covenantee and his successors in title and the persons deriving title under him or them ", section 79 [...] deems the covenant to be made "*on behalf of* [the covenantor] and his successors in title and the persons deriving title under him or them". Whatever the precise scope of the word "deemed" is in each section, this difference in

[46] Newsome, 'Universal Annexation' (1981) 97 LQR 32, (1982) 98 LQR 202; Snape, 'The Benefit and Burden of Covenants: Now Where Are We?' (1994) 3 Nott LJ 68; but see Hurst, 'The Transmission of Restrictive Covenants' (1982) 2 LS 53.

[47] See section 2.1.

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wording makes it clear that the benefit is, in principle, to pass to the covenantor's successors etc quite easily, whilst section 79 is intended, in the absence of contrary intention, to ensure that the burden remains firmly with the original covenantor.

The second objection is that, whilst s 79 expressly gives way to a contrary intention, s 78 does not. This objection is considered in the following case, in which the vendor of plots sold off from an estate imposed building restrictions, but provided that the benefit of these restrictions should not pass unless expressly assigned.

Roake v Chadha
[1984] 1 WLR 40, HC

Paul Baker QC

At 45

The *Federated Homes case* shows that section 78 of the Act of 1925 brings about annexation, and that the operation of the section cannot be excluded by a contrary intention. As I have indicated, he supports this last point by reference to section 79, which is expressed to operate "unless a contrary intention is expressed," a qualification which, as we have already noticed, is absent from section 78. Mr. Walter could not suggest any reason of policy why section 78 should be mandatory, unlike, for example, section 146 of the Act of 1925, which deals with restrictions on the right to forfeiture of leases and which, by an express provision "has effect notwithstanding any stipulation to the contrary."

I am thus far from satisfied that section 78 has the mandatory operation which Mr. Walter claimed for it. But if one accepts that it is not subject to a contrary intention, I do not consider that it has the effect of annexing the benefit of the covenant in each and every case irrespective of the other express terms of the covenant.

The true position as I see it is that even where a covenant is deemed to be made with successors in title as section 78 requires, one still has to construe the covenant as a whole to see whether the benefit of the covenant is annexed. Where one finds, as in the *Federated Homes case*, the covenant is not qualified in any way, annexation may be readily inferred; but where, as in the present case, it is expressly provided:

> "this covenant shall not enure for the benefit of any owner or subsequent purchaser of any part of the vendor's Sudbury Court Estate at Wembley unless the benefit of this covenant shall be expressly assigned [. . .]"

One cannot just ignore these words. One may not be able to exclude the operation of the section in widening the range of the covenantees, but one has to consider the covenant as a whole to determine its true effect. When one does that, then it seems to me that the answer is plain and in my judgment the benefit was not annexed. That is giving full weight to both the statute in force and also what is already there in the covenant.

The Court of Appeal indorsed this view in the following case, by explaining that 'successors in title' is limited to those purchasers who are intended to benefit from the covenant and thus a contrary intention may exclude certain purchasers.[48]

[48] A contrary intention has been found in the following cases *Margerison v Bates* [2008] EWHC 1211; *Norwich City College of Further and Higher Education v McQuillin* [2009] EWHC 1496; *Churchhill v Temple* [2010] EWHC 3369.

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Crest Nicholson Residential (South) Ltd v McAllister
[2004] 1 WLR 2409, CA

Chadwick LJ

At [41]–[44]

I respectfully agree, first, that it is impossible to identify any reason of policy why a covenantor should not, by express words, be entitled to limit the scope of the obligation which he is undertaking; nor why a covenantee should not be able to accept a covenant for his own benefit on terms that the benefit does not pass automatically to all those to whom he sells on parts of his retained land. As Brightman LJ pointed out, in the passage cited by Judge Paul Baker QC, a developer who is selling off land in lots might well want to retain the benefit of a building restriction under his own control. Where, as in *Roake v Chadha* and the present case, development land is sold off in plots without imposing a building scheme, it seems to me very likely that the developer will wish to retain exclusive power to give or withhold consent to a modification or relaxation of a restriction on building which he imposes on each purchaser; unfettered by the need to obtain the consent of every subsequent purchaser to whom (after imposing the covenant) he has sold off other plots on the development land. I can see no reason why, if original covenantor and covenantee make clear their mutual intention in that respect, the legislature should wish to prevent effect being given to that intention.

Second, it is important to keep in mind that, for the purposes of its application to restrictive covenants-which is the context in which this question arises where neither of the parties to the dispute were, themselves, party to the instrument imposing the covenant or express assignees of the benefit of the covenant-section 78 of the 1925 Act defines "successors in title" as the owners and occupiers of the time being *of the land of the covenantee intended to be benefited*. In a case where the parties to the instrument make clear their intention that land retained by the covenantee at the time of the conveyance effected by the transfer is to have the benefit of the covenant only for so long as it continues to be in the ownership of the original covenantee, and not after it has been sold on by the original covenantee—unless the benefit of the covenant is expressly assigned to the new owner—*the land of the covenantee intended to be benefited* is identified by the instrument as (i) so much of the retained land as from time to time has not been sold off by the original covenantee and (ii) so much of the retained land as has been sold off with the benefit of an express assignment, but as not including (iii) so much of the land as has been sold off without the benefit of an express assignment. I agree with the judge in *Roake v Chadha* that, in such a case, it is possible to give full effect to the statute and to the terms of the covenant.

This approach to section 78 of the 1925 Act provides, as it seems to me, the answer to the question why, if the legislature did not intend to distinguish between the effect of section 78 (mandatory) and the effect of section 79 (subject to contrary intention), it did not include the words "unless a contrary intention is expressed" in the first of those sections. The answer is that it did not need to. The qualification "subject to contrary intention" is implicit in the definition of "successors in title" which appears in section 78(1); that is the effect of the words "the land of the covenantee intended to be benefited". If the terms in which the covenant is imposed show—as they did in *Marquess of Zetland v Driver* and in *Roake v Chadha*—that the land of the covenantee intended to be benefited does not include land which may subsequently be sold off by the original covenantee in circumstances where (at the time of that subsequent sale) there is no express assignment of the benefit of the covenant, then the owners and occupiers of the land sold off in those circumstances are not "owners and occupiers for the time being of the land of the covenantee intended to be benefited"; and so are

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not "successors in title" of the original covenantee for the purposes of section 78(1) in its application to covenants restrictive of the user of land.

By contrast, the definition of "successors in title" for the purposes of section 79(1) appears in subsection (2) of that section: "the owners and occupiers for the time being of *such* land". In that context "such land" means "any land of a covenantor or capable of being bound by him [to which the covenant relates]." The counterpart in section 79 of "land of the covenantee intended to be benefited" (in section 78(1)) is "such land". "Such land" in that context means the land referred to in section 79(1); that is to say "any land of a covenantor or capable of being bound by him". But section 79(1) imposes two qualifications; (i) the land must be land to which the covenant relates and (ii) there must be no expression of contrary intention. The section could, perhaps, have described the land as "land of the covenantor (or capable of being bound by him) intended to be burdened". But the effect would have been the same. If the parties did not intend that land, burdened while in the ownership of the covenantor, should continue to be subject to the burden in hands of his successors (or some of his successors), they could say so. On a true analysis there is no difference in treatment in the two sections. There is a difference in the drafting technique used to achieve the same substantive result. That may well simply reflect the legislative history of the two sections. Section 78(1) of the 1925 Act re-enacted section 58 of the Conveyancing and Law of Property Act 1881 (44 & 45 Vict c 41) as applied by section 96(3) of the Law of Property Act 1922 and amended by section 3 of, and paragraph 11 of Schedule 3 to, the Law of Property (Amendment) Act 1924. Section 79 was a new provision, first introduced in the 1925 Act.

Statutory annexation may address the first evidential concern—namely, to demonstrate an intention that the benefit is to run to the covenantee's successors in title as owners of the dominant land—but it is still necessary to satisfy the second evidential requirement that the dominant land is adequately identified.[49]

Crest Nicholson Residential (South) Ltd v McAllister
[2004] 1 WLR 2409, CA

Facts: Crest intended to develop land that formerly comprised a number of different plots, originally sold off between 1926 and 1936, when they were made subject to similar covenants restricting their development and user. Some of the covenants contained express words of annexation, but others did not. Mrs McAllister, who lived in a house built on part of the plot sold off in 1936, opposed the development, claiming to be entitled to the benefit of the covenants. She was unsuccessful. Her land was insufficiently identified for the benefit to be expressly annexed or annexed via s 78.

Chadwick LJ

At [30]

The decision of this court in the *Federated Homes case* leaves open the question whether section 78 of the 1925 Act only effects annexation when the land intended to be benefited is described in the instrument itself (by express words or necessary implication, albeit that it may be necessary to have regard to evidence outside the document fully to identify that land) or whether it is enough that it can be shown, from evidence wholly outside the document,

[49] See also *Mohammadzadeh v Joseph* [2006] EWHC 1040.

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that the covenant does in fact touch and concern land of the covenantee which can be identified.

[The judge then referred to the cases of *Rogers v Hosegood* and *Marquess of Zetland v Driver*.]

At [33]–[34]

In its later decision in the *Federated Homes case* this court held that the provisions of section 78 of the 1925 Act had made it unnecessary to state, in the conveyance, that the covenant was to be enforceable by persons deriving title under the covenantee or under his successors in title and the owner or occupier of the land intended to be benefited, or that the covenant was to run with the land intended to be benefited; but there is nothing in that case which suggests that it is no longer necessary that the land which is intended to be benefited should be so defined that it is easily ascertainable. In my view, that requirement, identified in *Marquess of Zetland v Driver* remains a necessary condition for annexation.

There are, I think, good reasons for that requirement. A restrictive covenant affecting land will not be enforceable in equity against a purchaser who acquires a legal estate in that land for value without notice of the covenant. A restrictive covenant imposed in an instrument made after 1925 is registrable as a land charge under class D(ii): section 10(1) of the Land Charges Act 1925 and, now, section 2(5) of the Land Charges Act 1972. If the title is registered, protection is effected by entering notice of the restrictive covenant on the register: section 50 of the Land Registration Act 1925 and, now, section 11 of the Land Registration Act 2002. Where practicable the notice shall be by reference to the instrument by which the covenant is imposed and a copy or abstract of that instrument shall be filed at the registry: section 50(1) of the Land Registration Act 1925 and section 3(5) of the Land Charges Act 1972. It is obviously desirable that a purchaser of land burdened with a restrictive covenant should be able not only to ascertain, by inspection of the entries on the relevant register, that the land is so burdened, but also to ascertain the land for which the benefit of the covenant was taken-so that he can identify who can enforce the covenant. That latter object is achieved if the land which is intended to be benefited is defined in the instrument so as to be easily ascertainable. To require a purchaser of land burdened with a restrictive covenant, but where the land for the benefit of which the covenant was taken is not described in the instrument, to make inquiries as to what (if any) land the original covenantee retained at the time of the conveyance and what (if any) of that retained land the covenant did, or might have, "touched and concerned" would be oppressive. It must be kept in mind that (as in the present case) the time at which the enforceability of the covenant becomes an issue may be long after the date of the instrument by which it was imposed.

Section 78 is, thus, not a panacea for poor covenant drafting. The land to be benefited must be identified '*from a description, plan or other reference in the conveyance itself, but aided, if necessary, by external evidence to identify the land so described, depicted or otherwise referred to*'.[50] Even so, as Howell points out, identifying the land intended to be benefited can be problematic—particularly where time has elapsed and the original covenantee's land has been fragmented.

[50] *Crest Nicholson Residential (South) Ltd v McAllister* [2004] EWCA Civ 410, [45], *per* Chadwick LJ. See also *Stocks v Whitgift Homes Ltd* [2001] EWCA Civ 1732. Note the different evidence required to identify the dominant land where the burden and benefit pass: see section 2.2 above.

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Howell, 'The Annexation of the Benefit of Covenants to Land' [2004] Conv 507, 513

> The necessity of the benefited land to be sufficiently identified is the same whether the covenant is annexed by express words or by s78. The problem is that actually identifying the land on the ground which is to be benefited may be impossible and raise all the difficulties of enquiry which Chadwick LJ deplored. Simply stating as in *Rogers v Hosegood* that the land to be benefited "is nearby" and is all the land owned by X is surely no identification at all. In *Marquess of Zetland v Driver* the covenant imposed in 1928 was expressed for the benefit of land which was part of a settlement set up in 1871. The breach of the covenant was in 1938 and as it happened the whole of the land settled in 1871 was still intact in the hands of the tenant for life in possession, so identification of the land benefited was straightforward. It would be different where the covenants were imposed many years before and the land to be benefited had been sold in pieces [...]
>
> There is no similar requirement in the law of easements that the land to be benefited be identified in the conveyance. In *Johnstone v Holdway* an express reservation of an easement of way which made no mention of land to be benefited was good since it could be identified by information known to the parties at the time. Again, the challenge to the validity of the easement was a relatively short time after the conveyance but there does not seem anything in the different natures of an easement and a restrictive covenant which justifies the difference in principle.

Drawing upon the easements analogy, arguments[51] have been put forward from time to time that the benefit of a covenant should pass under s 62 of the LPA 1925, which we considered in the last chapter. In both *Roake v Chadha*[52] and *Kumar v Dunning*,[53] however, the courts were unimpressed by the analogy and declined to accept that a covenant that is not annexed to the land is a right appertaining to it.[54]

3.3 BUILDING SCHEME

Early in the development of restrictive covenants, the Chancery courts recognized that the enforcement of common covenants within a development merited special consideration.[55] Where a building scheme or scheme of development can be proved, equity supports the reciprocal enforcement of common covenants between all owners of the development, creating, in effect, a 'local law'.[56] A building scheme thus permits both the burden and the benefit of a covenant to pass to all owners for the time being within the scheme, but it is in the context of determining who can sue that building schemes are most often employed. The reason for this lies in the timing of sales.

[51] See Hayton (1971) 87 LQR 539, 570, and Wade (1972) 31 CLJ 157, 175. The argument was raised in *Federated Homes Ltd v Mill Lodge Properties Ltd* [1980] 1 WLR 594 and in *Shropshire CC v Edwards* (1982) 46 P & CR 270, 279, but in each case, the courts have declined to consider the issue.

[52] [1984] 1 WLR 40, 46. [53] [1989] QB 193, 198.

[54] In *Sugarman v Porter* [2006] EWHC 331, a similar argument was rejected based upon s 63 of the Law of Property Act 1925.

[55] There is evidence of mutually enforceable covenants as early the late 1830s: see *Lawrence v South County Freeholds Ltd* [1939] Ch 656, 675, *per* Simonds J; *Re Pinewood Estates* [1958] Ch 280, 286, *per* Wynn Parry J.

[56] See *Reid v Bickerstaff* [1909] 2 Ch 305, 319, *per* Coxens Hardy MR; *Re Dolphin's Conveyance* [1970] Ch 654, 662, *per* Stamp J.

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3.3.1 The timing problem

Whilst the burden of a covenant can be imposed upon the sale of each plot within a development, the benefit is more difficult to pass once the first plots have been sold, because the dominant land shrinks. Thus, if we have a small development of ten plots, the benefit of covenants taken by the developer from the purchaser of Plot 1 may be annexed to the plots that the developer still owns (i.e. Plots 2–10). When Plot 2 is sold, the benefit of the covenants taken from the purchaser cannot be annexed to Plot 1, which, having been sold, does not form part of the developer's dominant land. By the time that the later plots are sold, the problem is magnified. Thus when Plot 9 is sold, the purchaser's covenants cannot be annexed to Plots 1–8; the benefit can only be annexed to the Plot 10. Once Plot 10 is sold, the developer retains no land capable of benefiting from the covenant, and thus neither the burden nor benefit of the covenants can pass.

3.3.2 A local law

Where a building scheme is found, timing is not an issue. All of the current owners of land within the scheme may sue (i.e. claim the benefit) and be sued (i.e. subject to the burden) on the common covenants, regardless of when the covenants were originally imposed upon their properties or when they acquired ownership.

The classic statement of the evidence required to prove a building scheme is found in Parker J's judgment in the following case.[57]

Elliston v Reacher
[1908] 2 Ch 374, HC

Parker J

At 384

[. . .] [I]t must be proved (1) that both the plaintiffs and defendants derive title under a common vendor; (2) that previously to selling the lands to which the plaintiffs and defendants are respectively entitled the vendor laid out his estate, or a defined portion thereof (including the lands purchased by the plaintiffs and defendants respectively), for sale in lots subject to restrictions intended to be imposed on all the lots, and which, though varying in details as to particular lots, are consistent and consistent only with some general scheme of development; (3) that these restrictions were intended by the common vendor to be and were for the benefit of all the lots intended to be sold, whether or not they were also intended to be and were for the benefit of other land retained by the vendor; and (4) that both the plaintiffs and the defendants, or their predecessors in title, purchased their lots from the common vendor upon the footing that the restrictions subject to which the purchases were made were to enure for the benefit of the other lots included in the general scheme whether or not they were also to enure for the benefit of other lands retained by the vendors. If these four points are established, I think that the plaintiffs, would in equity be entitled to enforce the restrictive covenants entered into by the defendants or their predecessors with the common vendor irrespective of the dates of the respective purchases.

[57] Approved on appeal at [1908] 2 Ch 665.

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Whilst these requirements will be met by many housing developments, in some cases, they have proved too prescriptive. As a result, the courts in recent decades have looked to the more general requirements articulated in the following case,[58] in which the Court of Appeal outlined two essential elements: first, that there must be a defined area of land subject to the scheme; and secondly, that there must be an intention that all owners of plots within that area are subject to, and have the benefit of, the covenants that are imposed on each plot.

Reid v Bickerstaff
[1909] 2 Ch 305, CA

Cozens Hardy MR

At 319

What are some of the essentials of a building scheme? In my opinion there must be a defined area within which the scheme is operative. Reciprocity is the foundation of the idea of a scheme. A purchaser of one parcel cannot be subject to an implied obligation to purchasers of an undefined and unknown area. He must know both the extent of his burden and the extent of his benefit. Not only must the area be defined, but the obligations to be imposed within that area must be defined. Those obligations need not be identical. For example, there may be houses of a certain value in one part and houses of a different value in another part. A building scheme is not created by the mere fact that the owner of an estate sells it in lots and takes varying covenants from various purchasers. There must be notice to the various purchasers of what I may venture to call the local law imposed by the vendors upon a definite area.

Buckley LJ

At 322

First as to the existence of a building scheme and the application of the doctrine of *Spicer v. Martin*. For the application of the principle of that case it is, I think, essential to establish as matter of fact the following state of things: that the vendor expressly or by implication contracted with the defendant in the action or his predecessor in title (whom I will call the purchaser) upon the footing that at the date of that contract the vendor told the purchaser that he was proposing to deal with a defined estate in a defined way, and that he offered to sell to the purchaser a plot forming a part of that defined estate on the terms that the purchaser should enter into such restrictive covenants relating to his plot as the scheme contemplated upon the footing that the purchaser should reciprocally have the benefit of such restrictive covenants relating to the other plots on the estate as were indicated by the scheme. There can be no building scheme unless two conditions are satisfied, namely, first, that defined lands constituting the estate to which the scheme relates shall be identified, and, secondly, that the nature and particulars of the scheme shall be sufficiently disclosed for the purchaser to have been informed that his restrictive covenants are imposed upon him for the benefit of other purchasers of plots within that defined estate with the reciprocal advantage that he shall as against such other purchasers be entitled to the benefit of such restrictive covenants as are in turn to be imposed upon them. Compliance with the first condition identifies the

[58] Decided only six months after *Elliston v Reacher*, and reflecting the earlier authorities of *Renals v Colishaw* (1878) 9 Ch D 125 and *Spicer v Martin* (1888) 14 App Cas 12. This relaxation is attributed to the cases of *Baxter v Four Oaks Properties Ltd* [1965] Ch 816 and *Re Dolphin's Conveyance* [1970] Ch 654.

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class of persons as between whom reciprocity of obligation is to exist. Compliance with the second discloses the nature of the obligations which are to be mutually enforceable. There must be as between the several purchasers' community of interest and reciprocity of obligation.

The first element reflects the concerns that we have already considered in the context of annexation. But in contrast to annexation, that area need not be precisely identified from the conveyance itself, '*provided it can be otherwise shown with reasonable certainty*'.[59]

The second element requires proof of intention that the covenants were imposed for the common benefit of all of the owners within the scheme.

Re Dolphin's Conveyance
[1970] Ch 654, HC

Facts: Robert Dolphin owned Selly Hill Estate in Birmingham. After his death, the bulk of the estate was sold off by nine conveyances: the first four were sold by his sisters, and the remaining five, by his nephew. All except the last were in identical form and contained covenants as to the type of house that could be built on each plot. The vendors further covenanted that they would impose similar covenants on the sale of other plots. The current owner of one of the plots wished to redevelop in breach of the covenants and requested a declaration on the enforceability of the covenants. The court decided that a building scheme had been created, although there was no common vendor and the estate had not been laid out into plots prior to its sale.

Stamp J

At 661

[. . .] [T]o quote a passage in the judgment of Cross J. in *Baxter v. Four Oaks Properties Ltd.* [1965] Ch, 816, 825:

> "[. . .] for well over 100 years past where the owner of land deals with it on the footing of imposing restrictive obligations on the use of various parts of it as and when he sells them off for the common benefit of himself (in so far as he retains any land) and of the various purchasers inter se a court of equity has been prepared to give effect to this common intention notwithstanding any technical difficulties involved."

It is the submission of the defendants that that was done by the vendors in the present case.

That it was the intention of the two Miss Dolphins, on the sale of the parcel comprised in Coleman's conveyance, that there should be imposed upon each and every part of the Selly Hill Estate the restrictions set out in the conveyance—precluding the erection of buildings other than dwelling houses having the characteristics specified in the restrictions—cannot be doubted. And each conveyance evidenced the same intention. Nor can it be doubted that

[59] *Per* Stamp J in *Re Dolphin's Conveyance* [1970] Ch 654, 659, applying *Marten v Flight Refuelling Ltd* [1962] Ch 115. The area was defined in the case by reference to evidence produced by the Town Clerk of Birmingham City Corporation that the area of the estate was well known, in the same sense that Richmond Park is well known. See also *Stocks v Whitgift Homes Ltd* [2001] EWCA Civ 1732.

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each purchaser, when he executed his conveyance, was aware of that intention. The covenant by the vendor in each conveyance, to the effect that the same restrictions would be placed on all future purchasers and lessees, makes this clear. Furthermore, I would, unless constrained by authority to the contrary, conclude as a matter of construction of Coleman's conveyance, and of all the others, that the vendor was dealing with the Selly Hill Estate on the footing of imposing obligations for the common benefit, as well of himself, as of the several purchasers of that estate. It is trite law that if you find conveyances of the several parts of an estate all containing the same or similar restrictive covenants with the vendor, that is not enough to impute an intention on the part of that vendor that the restrictions should be for the common benefit of the vendor and of the several purchasers inter se: for it is at least as likely that he imposed them for the benefit of himself and of the unsold part of the estate alone. That is not this case. Here there is the covenant by the vendors that on a sale or lease of any other part of Selly Hill Estate

> "it shall be sold or leased subject to the stipulations above mentioned numbered 1, 2, 3, 4, 5, 6, 7 and that the vendors their heirs or assigns will procure a covenant from each purchaser or lessee upon Selly Hill Estate to the effect of those seven stipulations."

What was the point of it? For what possible reason does a vendor of part of an estate who has extracted restrictive covenants from a purchaser, covenant with that purchaser that the other parts of the estate, when sold, shall contain the same restrictions, unless it be with the intention that the purchaser with whom he covenants, as well as he himself, shall have the benefits of the restrictions when imposed? In view of these covenants by the vendor in the several conveyances, I cannot do otherwise than find that the covenants were imposed, not only for the benefit of the vendors or of the unsold part of their estate, but as well for the benefit of the several purchasers. As a matter of construction of the conveyances, I find that what was intended, as well by the vendors as the several purchasers, was to lay down what has been referred to as a local law for the estate for the common benefit of all the several purchasers of it. The purpose of the covenant by the vendors was to enable each purchaser to have, as against the other purchasers, in one way or another, the benefit of the restrictions to which he had made himself subject.

Stamp J points out that the fact that similar covenants are taken from purchasers of several plots within an estate is not enough, although it is not necessarily an objection that different covenants are imposed on different properties within the estate.[60] What is required is that the covenants were taken on the understanding (of which all purchasers were aware) that they should be for the benefit of all of the purchasers of plots within the estate, not only the vendor. This wider community of interest was proved in *Re Dolphin's Conveyance*, because the vendor covenanted with each purchaser that he would impose the same user restrictions on the sale of each plot.

Proof of the requisite intention is a question of fact that may be proved from a number of sources. Early cases looked to a deed of mutual covenant entered into by all of the purchasers of plots—a convenient means where there are a limited number of plots all sold at the same time, but increasingly impractical where a large number of plots are sold over an extended period.[61] Deeds of mutual covenant are now rare and the necessary intention is more often found (as in *Re Dolphin's Conveyance*) from the terms of the conveyances themselves.

[60] *Elliston v Reacher* [1908] 2 Ch 374 , 387, *per* Parker J, [1908] 2 Ch 665, 672, *per* Coxens-Hardy MR.
[61] See *Baxter v Four Oaks Properties Ltd* [1965] Ch 816, 825.

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Occasionally, an intention may be gleaned from the surrounding circumstances when the courts look to the stricter approach of *Elliston v Reacher*.[62] The distinction between these circumstances helps to account for the so-called 'relaxation' of building scheme requirements between the time of *Elliston v Reacher* and more recent decisions.[63]

Re Dolphin's Conveyance
[1970] Ch 654, HC

Stamp J

At 662

As Cross J. pointed out in the course of the judgment in *Baxter v. Four Oaks Properties Ltd*, to which I have already referred, the intention that the several purchasers from a common vendor shall have the benefit of the restrictive covenants imposed on each of them, may be evidenced by the existence of a deed of mutual covenant to which all the several purchasers are to be parties. That common intention may also be evidenced by, or inferred from, the circumstances attending the sales: the existence of what has often been referred to in the authorities as a building scheme. I have been referred to a considerable number of authorities where the court has had to consider whether there were, or were not, present in the particular case those facts from which a building scheme—and, therefore, the common intention to lay down a local law involving reciprocal rights and obligations between the several purchasers—could properly be inferred. In *Elliston v. Reacher* [1908] 2 Ch. 374, 384, Parker J. laid down the necessary concomitants of such a scheme.

What has been argued before me is that here there is neither a deed of mutual covenant nor a building scheme. In the latter connection, it is pointed out that there was not a common vendor, for the parcels were sold off, first by the Dolphins and then by Watts. Nor, prior to the sales, had the vendors laid out the estate, or a defined portion of it, for sale in lots. Therefore, so it is urged, there were not present the factors which, on the authority of *Elliston v. Reacher*, are necessary before one can find the existence of a building scheme.

In my judgment, these submissions are not well founded. To hold that only where you find the necessary concomitants of a building scheme or a deed of mutual covenant can you give effect to the common intention found in the conveyances themselves, would, in my judgment, be to ignore the wider principle on which the building scheme cases are founded and to fly in the face of other authority of which the clearest and most recent is *Baxter v. Four Oaks Properties Ltd*. The building scheme cases stem, as I understand the law, from the wider rule that if there be found the common intention and the common interest referred to by Cross J. at p. 825 in *Baxter v. Four Oaks Properties Ltd*. the court will give effect to it, and are but an extension and example of that rule.

The local law of a building scheme is a creature of equity founded not on contract, but on a community of interests. Megarry J observed, in *Brunner v Greenslade*,[64] that '[t]*he major theoretical difficulties based on the law of covenant seem to me to disappear where instead there is an equity created by circumstances which is independent of contractual obligation*'. He

[62] See *Lund v Taylor* (1975) 31 P & CR 16; *Jamaica Mutual Life Assurance Society v Hillsborough Ltd* [1989] 1 WLR 1101; *Emile Elias & Co Ltd v Pine Groves Ltd* [1993] 1 WLR 305.

[63] A point that he reiterated when elevated to the Court of Appeal in *Lund v Taylor* (1975) 31 P & CR 16, 177.

[64] [1971] Ch 993, 10005. See also Parker J in *Elliston v Reacher* [1908] 2 Ch 374, 385.

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continued: '[I]*n the field of schemes of development, equity readily gives effect to the common intention notwithstanding any technical difficulties involved. It may be, indeed, that this is one of those branches of equity which work best when explained least.*'

It is a somewhat unusual equity. It may revive following the common ownership of plots within the scheme[65] and can apply with equal force where a lot within the scheme is subdivided into smaller units.[66]

3.3.3 Contractual solutions

Possible contractual solutions to the timing problem are provided by s 56 of the LPA 1925 and by s 1 of the Contracts (Rights of Third Parties) Act 1999.

Law of Property Act 1925, s 56(1)

(1) A person may take an immediate or other interest in land or other property, or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he may not be named as a party to the conveyance or other instrument.

In Chapter 6, section 2.2, we saw that when a covenantor makes a promise to a covenantee, a third party who also benefits from that covenant may, in limited circumstances, be able to rely on s 56 of the 1925 Act to acquire a direct right against the covenantor. Thus, if a covenant is expressed to be made not only with the developer (as the owner of the rest of the development), but also with the owners for the time being of the plots already sold, those owners are entitled to claim the benefit of the covenant as named covenantees.[67]

A similar result is achieved by the Contract (Rights of Third Parties) Act 1999, which governs covenants entered into after 11 May 2000.

Contract (Rights of Third Parties) Act 1999, s 1

(1) [. . .] a person, who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if:

(a) the contract expressly provides that he may, or

(b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by a third party.

(3) The third party must be expressly identified by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

As noted in Chapter 6, section 2.2, s 1 of the 1999 Act can also be used by a third party to acquire a direct right against a promisor. We saw there that the terms of s 1 of the 1999 Act open up possibilities beyond the circumstances catered for by s 56(1) of the LPA 1925. In particular, the covenant does not have to be made with the non-party: it is sufficient if it is

[65] *Texaco Antilles v Kernochan* [1973] AC 609.
[66] *Brunner v Greenslade* [1971] Ch 993.
[67] These provisions also apply to restrictive covenants that do not form a building scheme.

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made for his or her benefit. Additionally, the non-party, whilst he or she must be identified by name or by a defined class, need not be in existence when the covenant is made. Thus a covenant could be made for the benefit of the future owners of the dominant land and come within the scope of s 1 of the 1999 Act, even though those owners (as a class) are not yet in existence when the covenant was made.

4 ENFORCEMENT, DISCHARGE, AND MODIFICATION OF COVENANTS

4.1 ENFORCEMENT

A restrictive covenant may be enforced by an award of damages or by the grant of an injunction, either prohibitory (to restrain a threatened or continuing breach) or mandatory (to require the covenantee to act to remedy a breach that has already occurred). Damages are available at law where action is against the original covenantor, and in equity, under Lord Cairns Act 1858, where a subsequent owner of the servient land has committed the breach. Injunctive relief is important because, in most cases, the owner of dominant land wishes to make sure that his or her neighbour does not act in breach of the covenant. Damages are unlikely to be considered an adequate remedy—but the award of an injunction is discretionary.

Millett LJ summarized in the following case the principles that the courts adopt when exercising that discretion.[68]

Jaggard v Sawyer
[1995] 1 WLR 269, CA

Millett LJ

At 287

When the plaintiff claims an injunction and the defendant asks the court to award damages instead, the proper approach for the court to adopt cannot be in doubt. Clearly the plaintiff must first establish a case for equitable relief, not only by proving his legal right and an actual or threatened infringement by the defendant, but also by overcoming all equitable defences such as laches, acquiescence or estoppel. If he succeeds in doing this, he is prima facie entitled to an injunction. The court may nevertheless in its discretion withhold injunctive relief and award damages instead. How is this discretion to be exercised? In a well known passage in *Shelfer v. City of London Electric Lighting Co.* [1895] 1 Ch. 287, 322–323, A. L. Smith L.J. set out what he described as "a good working rule" that

> "(1) If the injury to the plaintiff's legal right is small,
>
> (2) And is one which is capable of being estimated in money,
>
> (3) And is one which can be adequately compensated by a small money payment,
>
> (4) And the case is one in which it would be oppressive to the defendant to grant an injunction:—then damages in substitution for an injunction may be given."

[68] These principles have been affirmed by the Court of Appeal in the grant of an injunction to restrain a nuisance; see *Regan v Paul Properties Ltd* [2006] EWCA Civ 1391, [2007] Ch 135 and *Watson v Croft-Promo Sport Ltd* [2009] EWCA Civ 15.

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> Laid down just 100 years ago, A. L. Smith L.J.'s check-list has stood the test of time; but it needs to be remembered that it is only a working rule and does not purport to be an exhaustive statement of the circumstances in which damages may be awarded instead of an injunction.
>
> Reported cases are merely illustrations of circumstances in which particular judges have exercised their discretion, in some cases by granting an injunction, and in others by awarding damages instead. Since they are all cases on the exercise of a discretion, none of them is a binding authority on how the discretion should be exercised. The most that any of them can demonstrate is that in similar circumstances it would not be wrong to exercise the discretion in the same way. But it does not follow that it would be wrong to exercise it differently.
>
> The outcome of any particular case usually turns on the question: would it in all the circumstances be oppressive to the defendant to grant the injunction to which the plaintiff is prima facie entitled? Most of the cases in which the injunction has been refused are cases where the plaintiff has sought a mandatory injunction to pull down a building which infringes his right to light or which has been built in breach of a restrictive covenant. In such cases the court is faced with a fait accompli. The jurisdiction to grant a mandatory injunction in those circumstances cannot be doubted, but to grant it would subject the defendant to a loss out of all proportion to that which would be suffered by the plaintiff if it were refused, and would indeed deliver him to the plaintiff bound hand and foot to be subjected to any extortionate demands the plaintiff might make [. . .]
>
> In considering whether the grant of an injunction would be oppressive to the defendant, all the circumstances of the case have to be considered. At one extreme, the defendant may have acted openly and in good faith and in ignorance of the plaintiff's rights, and thereby inadvertently placed himself in a position where the grant of an injunction would either force him to yield to the plaintiff's extortionate demands or expose him to substantial loss. At the other extreme, the defendant may have acted with his eyes open and in full knowledge that he was invading the plaintiff's rights, and hurried on his work in the hope that by presenting the court with a fait accompli he could compel the plaintiff to accept monetary compensation. Most cases [. . .] fall somewhere in between.

Gray and Gray have noted the trend towards '*a new social ethic of "reasonableness between neighbours*"',[69] in which the enforcement of restrictive covenants through a monetary award rather than injunctive relief plays its part.

4.1.1 Injunction

The grant of an injunction is a natural remedy for breach of a restrictive covenant and there is an expectation that injunctive relief will be available.[70] A mandatory injunction is less readily granted, even though, by refusing injunctive relief, the court will be authorizing an unlawful state of affairs. As Millett LJ describes in *Jaggard v Sawyer*, the decision whether or not to grant an injunction can raise tricky issues: on the one hand, the courts is reluctant to sanction effectively the breach of a legal obligation; on the other hand, the dominant owner may not actually suffer any real monetary damage, and, indeed, may try to use the breach to extract some payment from the servient owner.[71] The court needs to balance whether or not damages provide an adequate remedy to the dominant owner against whether the grant

[69] Gray and Gray, *Elements of Land Law* (5th edn, 2009), [3.4.78] and [3.4.79].

[70] *Doherty v Allman* (1878) 3 App Cas 709.

[71] For example, in *Gafford v Graham* (1999) 77 P & CR 73, 83, the fact that Gafford tried to negotiate a release of the covenant was influential in the refusal of an injunction.

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of an injunction would cause oppression to the servient owner.[72] Nevertheless, a mandatory injunction may be granted where the covenantor's conduct is particularly reprehensible, because, for example, the breach is in flagrant disregard of warnings.[73]

Timing can present problems for the dominant owner seeking an injunction. As we have seen, the law in this area is far from straightforward and the case may not be finally heard for some time.[74] The dominant owner can preserve the status quo by seeking an interlocutory injunction pending the full hearing, but he or she will have to give an undertaking that he or she will indemnify the servient owner if the case is lost. If the dominant owner fails to seek interlocutory relief, however, he or she runs the risk that the court will be less inclined to grant an injunction at the final hearing.[75]

4.1.2 Damages

As Millett LJ explained in the above extract from *Jaggard v Sawyer*, damages will be granted where it would be oppressive to grant an injunction, and where the dominant owner's damage is small and capable of monetary estimation, so that compensation provides adequate redress.[76]

At common law, the measure of damages is guided by the loss suffered by the dominant owner.[77] Equitable damages under Lord Cairns Act 1858 may be awarded where the dominant owner continues to live with the effects of the breach: for example, where a user or building restriction is breached, even though there is little (if any) monetary loss to the value of the land. Damages in this case reflect the market cost to secure a release of the covenant.[78] The measure of damages both at common law and equity thus remains compensatory, rather than restitutionary.[79]

Nourse LJ explains the position in the following case.

Gafford v Graham
(1999) 77 P & CR 73, CA

Nourse LJ

At 86

A welcome consequence of *Jaggard v. Sawyer* is that it has firmly established the *Wrotham Park* basis of assessing damages as the basis appropriate to cases such as this. There have

[72] See *Shepherd Homes Ltd v Sandham* [1971] Ch 340, in which the court refused to order a mandatory injunction to pull down a fence built in breach of covenant where the claimant had delayed in bringing the action and the defendant intended to apply for the discharge of the covenant. See also *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798 and *Site Developments (Ferndown) Ltd v Barrett Homes Ltd* [2007] EWHC 415.

[73] See *Wakeham v Wood* (1982) 43 P & CR 40, but see *Wrotham Park Estate Co v Parkside Homes Ltd* [1974] 1 WLR 798.

[74] In *Gafford v Graham* (1999) 77 P & CR 73, the case was not finally heard at first instance until 1996, some seven years after the breaches. The appeal was heard in 1998.

[75] See *Shaw v Applegate* [1977] 1 WLR 970 and *Gafford v Graham* (1999) 77 P & CR 73, 82.

[76] See *Shelfer v City of London Electric Lighting Co* [1895] 1 Ch 287.

[77] See *Surrey County Council v Bredero Homes Ltd* [1993] 1 WLR 1361.

[78] *Wrotham Park Estate Co Ltd v Parkside Home Ltd* [1974] 1 WLR 798; *Jaggard v Sawyer* [1995] 1 WLR 269; *Winter v Traditional & Contemporary Contracts* [2007] EWCA Civ 1088.

[79] This view has been criticized by restitution lawyers: see Birks (1993) 109 LQR 518; O'Dair [1993] 1 RLR 31. See also *AG for Hong Kong v Blake* [2001] 1 AC 268, 283.

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been some differences of opinion as to the correct analysis of that decision, the difficulty being, as the plaintiffs there conceded, that the defendants' breaches of covenant had caused no diminution in the value of the land to which the benefit of the covenant was annexed; see [1974] 1 W.L.R. at 182F–G. No doubt it was for that reason that in *Surrey County Council v. Bredero Homes Ltd* [1993] 1 W.L.R. 1361, 1369, Steyn L.J. expressed the view that the *Wrotham Park* damages were defensible only on the basis that they were restitutionary in nature. However, that view was rejected in *Jaggard v. Sawyer* by both Sir Thomas Bingham M.R. and Millett L.J. who, agreeing with Megarry V.-C. in *Tito v. Waddell (No. 2)* [1977] Ch. 106, 335, thought that Brightman's approach had been compensatory, in that the damages awarded were intended to compensate the plaintiffs for not having obtained the price they would have been able to obtain for giving their consent, had they been asked to give it.

The compensatory analysis, if accompanied by a recognition that it was not a diminution in value of the dominant tenement that was compensated, is perfectly acceptable. Equally, in a case where there has been such a diminution, there seems to be no reason why it should not be taken into account in assessing the sum which might reasonably have been demanded as a quid pro quo for relaxing the covenant. Whatever the correct analysis may be, *Jaggard v. Sawyer*, as both sides agree, is clear authority for the adoption of the *Wrotham Park* basis of assessing damages in this case. I therefore proceed to assess them by reference to the sum which the plaintiff might reasonably have demanded as a quid pro quo for relaxing the restrictions in perpetuity [. . .]

4.1.3 Defences

A servient owner may defend an action for breach of covenant on a number of grounds. We have already seen that the dominant owner must be able to claim the benefit of the covenant in order to sue upon it and that the servient owner must be bound by the covenant, both because it qualifies as a restrictive covenant and because it is protected by appropriate registration.

In addition, the servient owner may argue that his or her actions do not constitute a breach on a proper construction of the covenant, or because the dominant owner agreed to release the covenant. The action or inaction of the dominant owner may give rise to an implied release by way of estoppel where it would be unconscionable to allow the dominant owner to enforce the covenant. An estoppel may arise where the dominant owner is implicated in the breach,[80] or, as a result of his or her acquiescence, where he or she knows of the breach, but fails to take sufficiently prompt action.[81]

4.2 EXTINCTION AND MODIFICATION OF COVENANTS

The character of neighbourhoods change over time, so that the covenants imposed on a particular piece of land or estate may outlive their usefulness and impose a break on much-needed development. In addition to the limits on injunctive relief already considered, the court may, on rare occasions, be persuaded that a covenant should not be enforced because it has become obsolete.[82]

[80] *Sayers v Collyer* (1885) 28 Ch D 103.

[81] See *Gafford v Graham* (1998) 77 P & CR 73, 80.

[82] See *Duke of Bedford v British Museum Trustees* (1822) 2 My & K 552; *Sobey v Sainsbury* [1913] 2 Ch 513; *Chatsworth Estates Co v Fewell* [1931] 1 Ch 224; *AG for Hong Kong v Fairfax Ltd* [1997] 1 WLR 149.

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Far more significant, however, is the jurisdiction of the Lands Chamber of the Upper Tribunal to discharge or modify a restrictive covenant conferred by s 84 of the LPA 1925.[83] It is not uncommon for enforcement proceedings to be stayed to allow the servient owner to make such an application.[84] An application may be made by any person interested in the servient land in respect of any restrictive covenant whenever made for valuable consideration.[85] The application is publicized, to alert the owners of any dominant land in the neighbourhood who may wish to object and then can be joined as parties.[86]

Law of Property Act 1925, s 84(1)

The Upper Tribunal shall [. . .] have power from time to time, on the application of any person interested in any freehold land affected by any restriction arising under covenant or otherwise as to the user thereof or the building thereon, by order wholly or partially to discharge or modify any such restriction on being satisfied—

(a) that by reason of changes in the character of the property or the neighbourhood or other circumstances of the case which the Upper Tribunal may deem material, the restriction ought to be deemed obsolete; or

(aa) that (in a case falling within subsection 1A below) the continued existence thereof would impede some reasonable user of the land for public or private purposes or, as the case may be, would unless modified so impede such user; or

(b) that the persons of full age and capacity for the time being or from time to time entitled to the benefit of the restriction, whether in respect of estates in fee simple or any lesser estates or interests in the property to which the benefit of the restriction is annexed, have agreed, either expressly or by implication, by their acts or omissions, to the same being discharged or modified; or

(c) that the proposed discharge or modification will not injure the persons entitled to the benefit of the restriction; [. . .]

Discharge or modification on the grounds of consent in s 84(1)(b) does not usually raise any particular problems, so we will concentrate on the remaining grounds.

4.2.1 Ground (a): obsolescence

The yardstick of obsolescence is whether or not, in the light of changes to the servient land or the surrounding area, the restriction still achieves its *original* purpose.[87] An obsolete covenant may still retain some value to the dominant owner because it achieves another purpose that was not originally contemplated, but this is relevant only to grounds (aa) or (c).[88] The reasonableness of the servient owner's proposed use is also an issue for ground (aa) rather than ground (a).[89]

[83] The section does not apply to positive covenants.

[84] The Lands Tribunal may also order consideration to be paid: see Law of Property Act 1925, s 84(1) and (1A).

[85] Ibid, s 84(7). [86] Ibid, s 84(3).

[87] *Re Truman Hanbury Buxton & Co Ltd's Application* [1956] 1 QB 261. See *Re Quaffers Ltd* (1988) 56 P & CR 142, in which the covenants were obsolete as soon as they were imposed because of the motorway network that surrounded the land.

[88] *Re Kennet Properties Ltd's Application* (1996) 72 P & CR 353.

[89] *McMorris v Brown* [1999] 1 AC 142, 147.

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4.2.2 Ground (aa): obstruction of reasonable user

This ground was added in 1970 to expand the Upper Tribunal's jurisdiction to balance public utility against the current benefits derived from the covenant, when the damage caused by its removal or modification can be compensated in money. The obstruction of reasonable user needs to be considered in the light of s 84(1A) and (1B) of the 1925 Act.

Law of Property Act 1925, s 84(1A) and (1B)

(1A) Subsection (1)(aa) above authorises the discharge or modification of a restriction by reference to its impeding some reasonable user of land in any case in which the Upper Tribunal is satisfied that the restriction, in impeding that user, either—

(a) does not secure to person entitled to the benefit of it any practical benefits of substantial value or advantage to them; or

(b) is contrary to the public interest;

and that money will be an adequate compensation for the loss or disadvantage (if any) which any such person will suffer from the discharge or modification.

(1B) In determining whether a case is one falling within subsection (1A) above, and in determining whether (in any such case or otherwise) a restriction ought to be discharged or modified, the Upper Tribunal shall take into account the development plan and any declared or ascertainable pattern for the grant or refusal of planning permissions in the relevant areas, as well as the period at which and context in which the restriction was created or imposed and any other material circumstances.

The Upper Tribunal must thus:

- consider the reasonableness of the proposed user;
- be satisfied either that the covenant no longer provides any practical benefit of substantial value or advantage to the dominant owner, or that the covenant is contrary to the public interest; and
- be satisfied that any damage that its removal or modification may cause can be adequately addressed by monetary compensation.

The reasonableness of the proposed user does not normally present a problem, thus attention is focused upon the practical benefit or advantage.

In considering the value of the practical benefit, the Upper Tribunal looks not only to the original purpose of the covenant, but also to the present benefits which fall within the ambit of the covenant.[90] For example, surviving practical benefits might include retaining a property's value,[91] or preserving environmental advantages (including a view or privacy),[92] or the low density of a development even though the surrounding area is of a higher density.[93]

[90] *Stannard v Issa* [1987] AC 175; *Re Kennet Properties Ltd Application* (1996) 72 P & CR 353; *Sheppard v Turner* [2006] 2 P & CR 28.

[91] *Re Azfar's Application* (2002) 1 P & CR 215, *Duffield v Gandy* [2008] EWCA Civ 379.

[92] *Re Page's Application* (1996) 71 P & CR 440; *Re Azfar's Application* (2002) 1 P & CR 215.

[93] *Re Hydeshire Ltd's Application* (1994) 67 P & CR 93; *Re Snaith and Dolding's Application* (1995) 67 P & CR 93.

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In this respect, a higher burden of proof will be required to displace the evident community interest of covenants under a building scheme.[94] The alternative filter of public interest is less commonly asserted. Here, it is not enough that proposed user is in the public interest; the covenant, by preventing that user, must be shown to be contrary to the public interest. Thus the need for building land[95] or for a particular community facility, such as a residential home,[96] will not necessarily suffice where there is other suitable land available. In determining the public interest, the Upper Tribunal is required by s 54(1B) to consider the planning policies applied in the area, as evidenced by the development plan and the pattern of planning decisions.

If the Upper Tribunal decides to discharge or modify the covenant, then it may order the servient owner to pay the dominant owner compensation either for any damage that the dominant owner has suffered, or to account for the increased value of the servient land now that it is freed for the restriction.[97]

4.2.3 Ground (b): no injury to the dominant owner

The last ground provides a long-stop test against vexatious objections and, as such, provides the most stringent test.[98] No compensation is payable to the dominant owner because no loss has been suffered. In determining whether or not the dominant owner's interest is injured, the courts are sympathetic to 'the thin end of the wedge' argument that whilst relaxing a covenant in the current situation may not be particularly injurious, it may be so because of its consequences for future applications and development.[99]

It is clear that '*restrictive covenants cannot be regarded as absolute and inviolable for all time*'.[100] Where a court exercises its discretion to award damages in lieu of an injunction, a clear breach of covenant is condoned and the dominant owner is forced to accept monetary compensation.[101] Likewise, where the Upper Tribunal is persuaded to discharge or modify a covenant, a dominant owner is powerless to prevent the unwanted development. But the rationale underlying the proprietary nature of covenants lies in the amenity that they afford. Where those continuing benefits can no longer be justified against wider social utility, a covenant's proprietary status is in jeopardy. There are human rights implications here, but there have been few serious challenges either to the exercise of the courts' discretion, or to s 84.[102] Any interference that there may be with the dominant owner's possessions is more than likely to be justified under the public interest balance upon which enforcement, modification, or discharge decisions are made.

The ability to sweep away unwanted burdens has played its part in lifting the rigidity of the 'conveyancer's view' of covenants to allow the judiciary to develop a more flexible attitude to those covenants that continue to serve their purpose.[103]

94 *Re Lee's Application* (1996) 72 P & CR 439.

95 *Re Collins Application* (1974) 30 P & CR 527.

96 *Re Azfar's Application* (2002) 1 P & CR 215, but see *Re Lloyds and Lloyds Application* (1993) 66 P & CR 112.

97 Law of Property Act 1925, s 84(1).

98 *Re Kennet's Application* (1996) 72 P & CR 353; *McMorris v Brown* [1991] 1 AC 142.

99 *McMorris v Brown* [1991] 1 AC 142, 151.

100 *Per* Lord Bingham in *Jaggard v Sawyer* [1995] 1 WLR 296, 283.

101 Mrs Jaggard complained of 'expropriation' of her property: see ibid, at 286.

102 See *Scott v UK* (App No 10741/84); *Lawntown Ltd v Kamenzuli* [2007] EWCA Civ 949; *Site Developments (Ferndown) Ltd v Barrett Homes Ltd* [2007] EWHC 415.

103 Gray and Gray, *Elements of Land Law* (5th edn, 2009), [3.4.84].

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5 REFORM

There have long been calls for the reform of the law governing land covenants. The main defects identified are the need to provide for the running of the burden of positive covenants, the undue complexity of the rules governing the running of the benefit of covenants, the difficulty of identifying the dominant land to which the benefit of a covenant is attached, and the continuing contractual liability of the original parties to the covenant.[104]

The call for positive obligations to run is particularly acute where landowners enjoy common facilities and it is necessary to provide effective mechanisms for the use, maintenance, and repair of those facilities. In the next chapter, we will be examining the measures adopted to address this issue between flat-owners—through the use of leasehold covenants and the introduction of commonhold tenure—but there may still be instances when other positive obligations need to be enforced between adjoining freehold owners.

Reform recommendations have been put forward on a number of occasions.[105] The latest proposals are found in the Law Commission's Report, *Making Land Work*, *Easements, Covenants and Profits à Prendre*.[106] The suggestion is to phase out restrictive covenants and introduce a new proprietary interest for both unregistered and registered land; the land obligation.

Law Commission, Law Comm 327 (2011)

At [5.69]–[5.70]

We recommend that the owner of an estate in land shall be able to create positive and negative obligations that will be able to take effect (subject to the formal requirements for the creation of legal interests) as legal interests appurtenant to another estate in land, and therefore as registrable interests pursuant to the Land Registration Act 2002, provided that:

(1) the benefit of the obligation touches and concerns the benefited land;

(2) the obligation is either:

  (a) an obligation not to do something on the burdened land;

  (b) an obligation to do something on the burdened land or on the boundary (or any structure or feature that is treated as marking or lying on the boundary) of the burdened and benefited land; or

  (c) an obligation to make a payment in return for the performance of an obligation of the kind mentioned in paragraph (b); and

(3) the obligation is not made between lessor and lessee and relating to the demised premises.

104 Law Commission, Law Comm 327 (2011), [5.4].

105 See *Report of the Committee on Positive Covenants Affecting Land* (Cmnd 2710, 1965); Law Commission Report No 11, *Transfer of Land: Report on Restrictive Covenants* (1967); Law Commission Working Paper No 36, *Transfer of Land: Appurtenant Rights* (1971); Law Commission Report No 127, *Transfer of Land: The Law of Positive and Restrictive Covenants* (1984); Law Commission Report No 201, *Transfer of Land: Obsolete Restrictive Covenants* (1991). The history of these recommendations is summarized in the latest report Law Commission Consultation Paper 186 (2008), [7.1]–[7.8].

106 Law Comm 327 (2011), see Pts 5 and 6.

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> 5.70 We recommend that for the future, covenants made by the owner of an estate in land and that satisfy the conditions set out above shall take effect, not as promises and not in accordance with the current law relating to restrictive covenants, but as legal interests in the burdened land, appurtenant to the benefited estate in land.

These recommendations provide a final acknowledgement that a covenant affecting land should be a '*genuine proprietary interests*' rather than a '*a peculiar species of personal contract*.'[107] A land obligation would give its holder a legal interest in land (rather than an equitable interest) with the benefit and burden of the obligation binding later parties acquiring all or any of the dominant land or servient land without the need either to rely on the rule in *Tulk v Moxhay* or to establish one of the three methods of passing the benefit of a covenant that we have examined.[108] The enforceability of land obligations would, thus, be brought into line with the enforceability of easements.

A land obligation could be either negative or positive, including a payment to support the expense of performing a reciprocal obligation; for instance to contribute to the repair costs of a shared facility. However, a land obligation must relate to land in the sense that it must 'touch and concern' the dominant land. It would be created by deed[109] and completed by registration. [110] Where land is registered, the benefit would be recorded in the property register of the dominant land and the burden in the charges register of the servient land. A plan would be required to identify the two pieces of land adequately. Where land is unregistered, it would only be possible for the burden to be registered as a land charge as there is no mechanism in the Land Charges Act 1972 to identify the dominant land.

The recommendation to introduce a new form of property right is a bold move. McFarlane has noted, in the context of the *Numerus Clausus Principle* which advocates a limited list of property rights that can bind third parties, that 'a strong case must be made before a new type of property right can be recognised, especially [. . .] to perform a positive act'.[111] The Law Commission have tried to make that case and to reinforce the argument by providing certain limitation to protect third parties against onerous obligations. Those limitations are, first, measures that operate up-front to confine the new form of land obligation to covenants that touch and concern the dominant land and, secondly, measures to promote public knowledge of land obligations through registration. In addition the s 84 jurisdiction to discharge and modify land obligations would provide a final escape route. Not all are convinced of the necessity of the proposed land obligation particularly in the light of the existing methods (in particular commonhold—see Chapter 27) by which positive obligations can be imposed upon third parties.

107 Wade, 'Covenants: A Broad and Reasonable View' (1972) 31 CLJ 157, 170.

108 It is contemplated, however, that certain third parties (e.g. those with short leases or a mortgagee who has not taken possession) will not be bound by a positive land obligation see Law Comm 327, [6.98], [6.101]–[6.104] and [6.115].

109 It could not be created by implication see Law Comm 327, [6.62].

110 An equitable land obligation could be created by the doctrine of anticipation (Chapter 9) see Law Comm 327, [6.52].

111 B. McFarlane, 'The Numerus Clausus Principle and Covenants Relating to Land' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011), p 328.

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O'Connor, 'Careful what you wish for: positive freehold covenants'
[2011] Conv 191, [206]

Like other limiting rules in the law of covenants, the *Austerberry* rule serves to balance competing interests: "freedom of contract" versus "freedom from transaction" or intergenerational equity [. . .]

Many jurisdictions have arrived at a decision point. They can abolish the *Austerberry* rule and allow the developers to impose positive covenants. Or they can provide for the imposition of positive obligations on current and future landowners by legislation or by owner's corporation rules make under legislative authority [i.e. commonhold] [. . .]

To take the 'easy option' of abolishing the *Austerberry* rule would significantly expand the regulatory power of developers by allowing them to impose positive obligations as well as land use restrictions on present and future lot owners. Jurisdictions which already have CPD [e.g. commonhold] legislation may find that abolition of the *Austerberry* rule undermines the consumer protection elements of the legislation [. . .]

Jurisdictions which have abolished the Austerberry rule have generally imposed minimal *ex ante* controls, since the law still assigns covenants to the realm of choice rather than choicelessness. Instead, the reforming jurisdictions have relied on ex post removal of covenants by judicial order. This approach provides much less protection for burdened owners and significantly higher transactions costs [. . .]

The 'easy option' of opening the door to positive covenants may turn out to be the hard option in the long run. One person's onerous obligations is another person's valuable property right, the barriers to *ex post* relief are formidable. In an era of human rights, the need to provide compensation for extinguishment of property rights will significantly limit the ability of future legislators to protect purchasers and to relieve against onerous covenants. This may explain the reluctance of legislators in many jurisdictions to act upon recommendations to abolish the *Austerberry* rule.

QUESTIONS

1. Given the scope of public planning legislation, is there a continuing place for restrictive covenants in controlling land use?
2. How have the characteristics of restrictive covenants developed since *Tulk v Moxhay*?
3. Should the burden of a positive covenant run with the land as a general principle?
4. Restrictive covenants have been described as an equitable extension of either privity of estate or negative easements. How helpful are these analogies?
5. How does the courts' interpretation of ss 78 and 79 of the Law of Property Act 1925 differ? Is the difference justified?
6. Why is it important to identify the land to be benefited from a restrictive covenant?
7. Have the courts relaxed their approach to the proof of a building scheme?
8. Can the courts' approach to the enforcement of restrictive covenants be described as the compulsory purchase of the benefit of the covenant?

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FURTHER READING

Gardner, 'The Proprietary Effect of Contractual Obligations Under *Tulk v Moxhay* and *De Mattos v Gibson*' (1982) LQR 279

Gardner, 'Two Maxims of Equity' (1995) 54 CLJ 60

Hurst, 'The Transmission of Restrictive Covenants' (1982) 2 LS 53

Law Commission Consultation Paper No 186, *Easements, Covenants and Profits à Prendre* (2008)

Law Commission Report, *Making Land Work*, *Easements, Covenant and Profits à Prendre* Law Comm 327 (2011)

McFarlane, 'The Numerous Claus Principle and Covenants Relating to Land' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011, Ch 15)

O'Connor, Careful what you wish for: positive freehold covenants [2011] Conv 191

Snape, 'The Benefit and Burden of Covenants: now where are we?' (1994) 68 Nott LJ 68

Turano, 'Intention, Interpretation and the "Mystery" of Section 79 of the Law of Property Act 1925' [2000] Conv 377

Wade, 'Covenants: "A Broad and Reasonable View" ' (1972) 31 CLJ 157

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27

FLAT OWNERSHIP: LONG LEASES AND COMMONHOLD

CENTRAL ISSUES

1. Communal living calls for the reciprocal enforcement of negative and positive rights and obligations between flat owners, and for mechanisms to facilitate the use, maintenance and repair of the common areas and facilities. To overcome the difficulty of enforcing positive obligations between freehold landowners, flat ownership has adopted the long lease.
2. The ownership of flats is achieved by granting the flat owner a long lease of his or her flat, with the freehold reversion being held either by an independent landlord or by a company owned collectively by the flat owners. The management and repair of the communal areas and facilities is conducted by the landlord, and funded by service charges paid by the flat owners.
3. The long lease structure of flat ownership has been open to abuse, particularly where an independent landlord holds the freehold, but legislative reform has addressed the worst abuses.
4. Long leaseholders may collectively enfranchise or obtain an extended lease, exercise a right to manage, or question the reasonableness of service charges, cure by variation a defective lease, and seek some protection from forfeiture.
5. The Commonhold and Leasehold Reform Act 2002 introduced commonhold to provide a new framework for flat ownership. The flat owners own the freehold of their flats and communally own the freehold of the common parts through a commonhold association, which is responsible for the management of the development funded through commonhold assessments paid by the flat owners. The relationship of the flat owners is governed by a commonhold community statement, which binds all flat owners within the commonhold.

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1 INTRODUCTION

Owners of flats are the closest neighbours. They live one on top of each other, as well as side by side. The need to regulate the legal rights and obligations of flat owners within a block of flats is thus particularly significant. An acceptable living environment is important, and thus the user of individual flats and the block as a whole needs to be controlled: late night parties are occasional fun, but can be a nuisance if a nightly occurrence. Restrictive covenants (see Chapter 26) provide a convenient mechanism for control. It is also necessary for flat owners to enjoy limited rights over their neighbours' flats, as well as the common areas of the building (often referred to as the 'common', or 'communal' parts). Rights over the common parts will include rights of way to reach the flat, as well as rights of drainage and to services. There may be a right to use communal gardens, car parking space, and other common facilities. Rights over neighbouring flats will include rights of support for flats on the higher floors from the flats below and rights of protection for the flats on the lower floors from the flats above. The passage of services through the flats will also need to be accommodated. All of these rights can qualify as easements (see Chapter 24) attached to the dominant flats over the servient common parts or other flats over which the rights are exercised.

The missing link in this framework is the need for an effective mechanism for the maintenance and repair of the flat development. Here, there is a problem, because positive covenants (see Chapter 26) to repair or contribute to the costs of repair are not enforceable against subsequent freehold owners.

Clarke explains the problems.

Clarke, 'Occupying "Cheek by Jowl"' in *Land Law: Themes and Perspectives*
(eds Bright and Dewar, 1998, p 383)

> The common law was, however, unable to adequately cope with the demands of the horizontal division of property. In a simple example of a property on three floors with each floor comprising a flat or apartment with freehold title the person with title to the middle flat has only a freehold of a block of air space. The market value of such a title is dependent upon the support provided by the lower flat and the protection from the weather provided by the flat above. It is, therefore, essential that the freeholders of these flats are under an obligation to support, on the one hand, and maintain the roof, on the other. Indeed, there must be mutual enforceability of repairing obligations, with the middle flat-owner paying a fair proportion of the benefit by contributing to repair and maintenance. Such mutual enforceability is prevented by the common law principle that the burden of a freehold covenant does not run with the land. A subsequent owner cannot be forced to pay by virtue alone of title to the property.

Lawyers have tackled this problem by utilizing the lease, because, as we saw in Chapter 24, positive obligations can be made to run with the leasehold estate in land. Rather late in the day, Parliament has addressed the issue with the introduction of 'commonhold' under the Commonhold and Leasehold Reform Act 2002. In so doing, it has followed the lead of other common law jurisdictions, which have enacted similar statutory solutions, known variously as 'strata',[1] or 'condominium' title.[2]

[1] Strata title was introduced in New South Wales, but has spread throughout Australasia and to other common law jurisdictions, e.g. Singapore.

[2] Condominium title is found across North America.

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We should emphasize at the outset that we are concerned with long-term ownership solutions to multi-unit occupation of a building and not short-term tenancy agreements that provide the framework for mostly temporary living arrangements or public housing provision (whether of flats or houses).[3] Again, Clarke explains the context.

Clarke, 'Occupying "Cheek by Jowl"' in *Land Law: Themes and Perspectives*
(eds Bright and Dewar, 1998, p 378)

> A more obvious scenario where land law issues ought to exist is the renting of space for a periodic or short term in a single building such as a block of flats [. . .] It is often the least affluent in society who find they have no choice but to find a home in such a way. Public housing is frequently provided in this manner [. . .] The communal occupation with which this chapter is concerned is different. It occurs whenever a person seeks to purchase a proprietary interest of significant value of part of a building which is realizable by sale or assignment and which gives an exclusive right to occupy a part only of that building. Typically for a long lease at a low rent, a substantial upfront payment of premium will be paid to a developer or property-owner. The new occupier is generally styled 'leaseholder' rather than tenant, for although the basic relationship may be the same as a tenant paying a market rent, the expectations are very different. The new resident has not only secured a home under a shared roof but has invested capital in part of the property by means of the price paid when the flat was purchased. Such a leaseholder expects the investment to be permanent and recouped by a sale of the property interest at any time of his choosing. However, the value of that property interest will be reduced if the legal arrangements with the other occupiers are inadequate and by the rights of the freeholder who retains an interest in the building as a whole if those rights are adverse to the leaseholder. The leaseholders will have collective self interest in issues of repair, maintenance and management of the buildings as a whole and a degree of united and coherent action is often appropriate.

In this chapter, we will initially consider the long lease framework that lawyers have developed for flat ownership, noting the remedial statutory measures that have been enacted to address the specific problems that this solution presents. We will then look at the essential features of commonhold as an alternative framework. This is a complex area of the law, although, given the increasing density of development and the prevalence of communal living, one that is vital to many homeowners. It is evident that flat owners understandably are often unclear of their respective rights and obligations and the legal structures employed.[4]

We will not, however, be delving too deeply into this complexity, but will concentrate on offering an overview.

2 LONG LEASES OF FLATS

Long leases are privately negotiated contracts, and, as such, they come in all shapes and sizes. Variety is the spice—and sometimes the bane—of life, and conveyancers spend long hours drafting and reading different forms of long leases. The common features are that

[3] We cover short-term tenancy agreements in Chapter 23.

[4] See Cole and Robinson, 'Owners Yet Tenants: the Position of Leaseholders in Flats in England & Wales' (2000) 15 Housing Studies 595 and Blandy, Dixon & Dupuis, 'Theorising Power Relationships in Multi-owned Residential Developments: Unpacking the Bundle of Rights' (2006) 43 Urban Studies 2365.

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they are originally granted for an extended term at a market price (commonly referred to as a 'premium'), but for a low annual rental (commonly referred to as a 'ground rent'). They are leases, but, in terms of the value of the interest that they confer, they are intended to replicate the timeless ownership of freehold.

2.1 WHO IS THE LANDLORD?

The use of the long lease inevitably results in the division of estates in the land. There are the leases of the individual flats granted for terms varying from 99 to 999 years, which are held by the flat owners, and the freehold reversion on those leases, which, together with the freehold of the common parts, is held by the landlord.

Originally, the developer of the flats, as the freehold owner of the development, will grant the leases. The developer then has a choice in its sale of the development. It can sell the whole development without retaining any interest by selling the leases of the individual flats to purchasers for their market value, together with a share in a management company to which the developer transfers the freehold of the whole development, subject to the flat leases. Thus whilst the flat lessees own their own flats individually, they also communally own the freehold of the whole block, including the freehold of the common parts and the freehold reversion of the flat leases.

Alternatively, the developer can retain the freehold either directly or by transferring it to a company that it owns. The developer will choose this latter option where it wishes to retain the investment and income-producing opportunities that the freehold reversion represents. The investment return lies not in the annual ground rent from the lease, which will be low, but in the capital value of the freehold reversion, which will increase as the leasehold terms run their course and fall to be renewed. Given the common length of leasehold terms, this is a very long-term investment. A more attractive commercial opportunity is the income returns to be made from the provision of management services.

Davey explains the position of the landlord and some of the problems associated with long leases that legislation has tried to address.

Davey, 'The Regulation of Long *Residential* Leases' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005, p 206)

> Thus in the case of long leases of flats where there is an unrelated freeholder, there is a stark contrast between the interest of the landlord and the leaseholder. For the latter the property is his home in which he will have staked a considerable investment for a long-term interest. But what does ownership of the freehold mean to the landlord, especially where the flat leases have a long period to run? Its capital value is low, reflecting the low ground rent, so why would anyone want to be a landlord in these circumstances? The answer lies in the management of services. In other words the freehold is a source of income and as such has an investment value. But this suggests of course that, for the business to be profitable, leaseholders must be paying through their service charge for more than the cost of the services to the landlord including his management expenses; this is the profit element. Some landlords also make a profit through placing insurance of the building with an insurer who pays commission to the landlord or by placing contracts for repairs and other services with associated companies.

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Thus the leasehold structure of flat ownership was ripe for exploitation and so it proved to be the case. The problems are legion and were first officially identified in a *Report on the Management of Privately Owned Blocks of Flats* published in 1985. They include:

- Delay in dealing with repairs;
- The levying of excessive charges;
- A lack of consultation and provision of information;
- A lack of sinking or contingency funds for infrequent but expensive major schemes of repair and renovation;
- The different levels of interest exhibited by absentee investor leaseholders and occupational leaseholders.

Other legal problems identified included uncertainties over enforcement of obligations, the need for cheap and convenient resolution of disputes, the unresolved question of ownership and taxation of sinking funds and the means of remedying defective leases.

Many of the problems associated with long leasehold are not so significant where the flat owners own the freehold collectively. They are their own landlords, and their leases are merely a convenient device to ensure that both the negative and positive covenants in their leases are enforceable by, and against, all of the flat owners in the block.

2.2 THE LEASEHOLD TERM, AND RIGHTS TO ENFRANCHISEMENT AND EXTENSION

Common long leasehold terms for flat developments are 99 or 125 years, and for specialist gated communities, 200 years is a common term. In times gone past, even longer terms of 999 years were sometimes granted. Time nevertheless ticks away and, where the residue of the term nudges the fifty or sixty-year mark, the lease starts to be considered a wasting asset that is declining in value year by year, and which will ultimately become unmortgageable and unmarketable. The only way in which the long lease can replicate the infinity of freehold ownership is thus for the leaseholder to negotiate with the landlord either to acquire the freehold (usually collectively with the other flat owners) or to extend his or her lease.

Rights to enfranchisement and to obtain an extended term were granted to leasehold flat owners by the Leasehold Reform Housing and Urban Development Act 1993.[5] The rights were notoriously complex to exercise,[6] but have been relaxed somewhat by the Commonhold and Leasehold Reform Act 2002.[7] A flat owner may obtain at a market premium an extended lease for a period equal to the unexpired residue of the lease plus ninety years. The right of an individual flat owner to obtain a longer lease of his or her flat, although easier to achieve than enfranchisement, is of limited value on its own. It is of more value for all of the flat owners to extend their leases and to acquire the freehold of the development. Collective enfranchisement may be achieved through a right to enfranchise company, in which all the flat owners

[5] Enfranchisement of leasehold houses was earlier granted by the Leasehold Reform Act 1967.

[6] See Clarke, 'Leasehold Enfranchisement: Leasehold Reform, Housing and Urban Development Act 1993' [1994] Conv 223.

[7] For example, the right to enfranchise may be exercised by a simple majority, rather than a two-thirds majority, and there is no longer a residency condition: see Commonhold and Leasehold Reform Act 2002, ss 119 and 120.

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are given an opportunity to become members, and through which they can participate in the enfranchisement claim. The company is able to acquire the freehold on behalf of the flat owners so that, collectively, the flat owners become their own landlords, with the freedom to extend their leases and take over the management of the block.

Taking over the management can, however, be a mixed blessing, as Davey explains.

Davey, 'The Regulation of Long Residential Leases' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005, p 221)

> [. . .] [O]n enfranchisement leaseholders may find that the management of a block of flats can be fraught, expensive and depressing business. They will become landlords of themselves and non-participating leaseholders as well as any non-long leaseholder tenants or commercial tenants, with all the responsibilities that entails. They will need to deal with contractors, comply with a host of regulatory requirements on health and safety employment etc. But this should not detract from the fact that leaseholders will now be in control and this often brings a high degree of satisfaction especially in smaller blocks. Furthermore the tribulations of management can be avoided to a considerable degree by the appointment of managing agents. However, this will not stop aggrieved leaseholders transferring their grievance from the freeholder to the new management company.

2.3 MAINTENANCE AND REPAIR

An effective machinery for the maintenance and repair of the block of flats is crucial. The most common structure is for the leaseholders of flats to be responsible for the repair maintenance of the interior of their individual flats, and for the landlord to take on responsibility for the repair and maintenance of the structure (including the roof and foundations), plus the common parts and facilities. The landlord's costs are then recovered from the individual flat owners through a periodic service charge, which may be supplemented by contributions to a sinking fund to meet major replacement expenditure or unexpected costs.

Two main problems can emerge: firstly, the flat leases may provide an inadequate repair and maintenance framework, because the division of responsibility is unsatisfactory; and secondly, the service charge provisions and their performance may be inadequate, and may operate unfairly. The first problem calls for a variation of the leases, to provide a more satisfactory repairing and maintenance framework, and will be considered below. The second has been the source of particular complaint, as Davey outlines in the above extract.[8] It has proved a challenging nut to crack. The solution is found in the flat owners gaining control over the management of their block and in the regulation of service charge levels.

2.3.1 The right to manage

The right of the flat owners to appoint a manager was first conferred by the Landlord and Tenant Act 1987, which was amended by the Housing Act 1996 and the Commonhold and Leasehold Reform Act 2002. The power was exercisable upon proof of some fault by the landlord or his or her managers: for example, the levying of unreasonable charges, or a

[8] These problems were first reviewed in a *Report on the Management of Privately Owned Flats* ('the Nugee Report') (1985).

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failure to comply with the Code of Practice approved under the Leasehold Reform Housing and Urban Development Act 1993.[9] This limited power, unfortunately, did not solve the problem: proof of fault was not always easy to establish, thus a new right to manage, without having to establish fault, was introduced by the 2002 Act. The right is exercisable by application to the Leasehold Valuation Tribunal for the appointment of a new manager, which may be exercised through the establishment of a right to manage company formed by the flat owners.[10] This company takes over the management duties and powers under the flat leases, without the flat owners having to enfranchise.

2.3.2 Levels of service charge

Excessive service charges have long been a source of complaint and have been the subject of regulation for all residential leases since 1972.[11] Control operates through ss 18–30 of the Landlord and Tenant Act 1985, and an extensive set of regulations. The controls relate to those variable charges that fall within the definition of 'service charge' being the variable sums payable by the flat owners for services, repairs, maintenance, improvements or insurance as well as the landlord's management costs. [12] The fixed charges sometimes found in short-term tenancies are excluded.

Service charges must satisfy three levels of reasonableness: firstly, the charge must be reasonably incurred; secondly, it must relate to works or services that are carried out to a reasonable standard; and finally, the amount payable should be reasonable.

Landlord and Tenant Act 1985, s 19

Limitation of service charges: reasonableness

(1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period—

(a) only to the extent that they are reasonably incurred, and

(b) where they are incurred on the provisions of services or the carrying out of works, only if the services or works are of a reasonable standard;

and the amount payable shall be limited accordingly.

(2) Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise.

The Leasehold Valuation Tribunal determines reasonableness on the application of either the landlord or the leaseholder, with each party bearing its own costs. The Tribunal can also determine on whom the liability falls under the terms of the lease.[13] The test of reasonableness

[9] See s 87. [10] Commonhold and Leasehold Reform Act 2002, s 21.

[11] See the Housing Finance Act 1971, which was amended by the Housing Act 1974 and the Housing Act 1980, before being consolidated in the Landlord and Tenant Act 1985, which itself has been subject to amendment by the Landlord and Tenant Act 1987, the Housing Act 1996, and the Commonhold and Leasehold Reform Act 2002.

[12] Landlord and Tenant Act 1985, s 18. [13] Landlord and Tenant Act 1985, s 27A.

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looks to the actual cost, excluding any element of profit to the landlord, and does not extend to the cost of managing agents employed by the landlord where that managing agent is an alter ego of the landlord.[14]

The Landlord and Tenant Act 1985 contains other useful protections for flat owners, including provisions giving tenants the right to challenge insurance effected by the landlord,[15] requiring consultation with flat owners before carrying out certain works,[16] requirements for statements of accounts,[17] and controls over the manner in which demands for service charges are made.[18] Other legislative controls call for service charges to be held in trust fund accounts[19] and enable the flat owners to effect their own insurance.[20]

2.4 COMMUNAL LIVING

Flat owners, as the closest neighbours, have to get along. The purpose of many of the negative user covenants in the flat leases is to provide a code of conduct for the flat development to maintain an acceptable, even attractive, living environment. The rules for the enforcement of leasehold covenants provide a route to legal redress where this code is breached, but there are a number of difficulties.

The enforcement of leasehold covenants is designed with a hierarchical structure in mind, thus landlord can sue leaseholder and vice versa. We have already seen that even enforcement against a subtenant falls outside the basic scheme and recourse to *Tulk v Moxhay* is required.[21] But problems of enforcement of user restrictions often lie between individual flat owners, presenting a need for horizontal control unless the landlord can be persuaded to become involved—a more realistic possibility where the flat owners own the freehold collectively through the corporate structure. Possible routes to horizontal enforcement may exist through proof of a building scheme, in which all of the flats are subject to common covenants, or where individual flat owners can otherwise claim the benefit of the covenants.[22] Even so, adversial court processes are ill equipped to resolve disputes between neighbours where continuing amicable relationships are so important.

2.5 VARIATION

The terms of a long lease are set in stone when it is first entered into. They are individually drafted documents, which vary from development to development, although all leases within a block should be in the same form to provide a coherent and common framework. If the leases are found to be defective, it can prove an insurmountable task to try to vary all of the leases. All of the flat owners, together with any lenders with mortgages secured against the leases, will need to agree and be involved in the process. Part IV of the Landlord and Tenant Act 1987 now provides a statutory power for the Leasehold Valuation Tribunal

[14] *Finchbourne Ltd v Rodrigues* [1976] 3 All ER 581; cf *Embassy Court Residents Association v Lipman* (1984) 271 EG 545, in which the landlord's administration charges were recoverable, and *New Pinehurst Residents Association (Cambridge) v Silow* [1988] 1 EGLR 227 and *Skilleter v Charles* [1992] 13 EG 113, in which the manager was not the alter ego of the landlord.

[15] Landlord and Tenant Act 1985, s 30A and Sch 1, para 9.

[16] Ibid, ss 20 and 20ZA.

[17] Ibid, ss 21, 21A, and 22.

[18] Ibid, s 21B.

[19] Landlord and Tenant Act 1987, ss 42, 42A, and 42B; Commonhold and Leasehold Reform Act 2002, s 156.

[20] Commonhold and Leasehold Reform Act 2002, s 162.

[21] Chapter 26, section 5.

[22] Chapter 26, section 3.3.

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to vary defective leases—although, unfortunately, the statutory definition of a 'defective lease' is rather restrictive.[23]

2.6 FORFEITURE

Leases of flats will contain a right for the landlord to forfeit and re-enter the flat in the event of the leaseholder failing to pay the rent or service charge, or failing to perform the other covenants contained in the lease. We have seen that a right of forfeiture can only be exercised following service of notice on the leaseholder and is subject to the courts' discretion to grant relief from forfeiture.[24] Nevertheless, it remains a draconian remedy, which marks a long leasehold estate out from the security offered by a freehold tenure, and which has been abused by landlords wishing to intimidate flat owners.[25]

A number of protections have been enacted to assist long leaseholders facing forfeiture for non-payment of rent or service charge: in particular, the amount of a disputed service charge must be determined by a court or the Tribunal,[26] and must exceed a prescribed amount or have been outstanding for a prescribed period.[27]

In respect of a breach of a covenant other than a covenant to pay rent the landlord cannot serve a notice under s 146(1) of the Law of Property Act 1925, or otherwise re-enter, unless the breach is admitted by the tenant or has been determined by a court or tribunal.[28] In addition, if the breach is of a repairing covenant, s 1 of the Leasehold Property (Repairs) Act 1938[29] provides that the s 146(1) notice must inform the leaseholder of his or her right to serve a counter-notice, and, upon service of a counter-notice, forfeiture cannot follow unless the court orders otherwise.[30] Leave will not be granted unless immediate repair is necessary, or unless the court considers it just and equitable.[31]

Many feel that these measures do not go far enough, and that forfeiture in the case of long leases is 'simply inappropriate' and should be abolished.[32]

3 COMMONHOLD

Commonhold has been described as '*a vital and necessary new form of land holding for the twenty-first century*'.[33] The Commonhold and Leasehold Reform Act 2002 introduced it to address the problems of flat ownership, although its application is not confined to flats, but can be used for the ownership of any residential or commercial development with shared facilities.

As its name suggests, commonhold is designed to facilitate communal living and working, by providing a structure for the ownership of individual units and the communal ownership, control, and management of common areas and facilities. It abandons the leasehold,

[23] See Landlord and Tenant Act 1987, s 35. [24] See Chapter 24, section 6.4.
[25] See ODPM Consultation Paper, *Restrictions on the Use of Forfeiture for Long Residential Leases* (2002).
[26] Housing Act 1996, s 81. [27] Commonhold and Leasehold Reform Act 2002, s 167.
[28] Commonhold and Leasehold Reform Act 2002, s 168.
[29] The Act applies to leases of more than seven years that have at least three years to run. See Smith, 'A Review of the Operation of the Leasehold Property (Repairs) Act 1938' [1986] Conv 85.
[30] Law of Property Act 1925, s 1(3). [31] Ibid, s 1(5), and *Sidnell v Wilson* [1966] 2 QB 67.
[32] See Davey, 'The Regulation of Long Residential Leases' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005), p 222. See Chapter 24, section 6.4, for the Law Commission's proposals for reform to forfeiture.
[33] Clarke, *Commonhold: The New Law* (2002), p 2.

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with, hopefully, the associated problems already considered, and instead provides a framework in which the freehold ownership of units, with communal areas and facilities, can be accommodated. As such, it does not introduce a new tenure or estate, but a new means of structuring freehold land ownership.[34]

3.1 THE STRUCTURE OF COMMONHOLD

A commonhold block of flats will be divided into individual freehold flats, held by each flat owner as a registered freehold proprietor, with the freehold of the common parts registered in the name of the commonhold association in which the flat owners are all members. As Van der Merwe and Smith point out, there are thus three elements to commonhold and a need to appreciate not only the property framework, but also company law, which governs the workings of the association.

Van Der Merwe and Smith, 'Commonhold—A Critical Appraisal' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2003, p 229)

> [. . .] [C]ommonhold is structured as a threefold unity combining ownership in a unit with collective rights with regard to the common parts and membership of the commonhold association [. . .] From the threefold unity embodied in commonhold, the institution straddles both the law of property and that of association.

The structure is similar to the leasehold structure, in which flat owners hold leases of their individual flats, and collectively own the freehold reversion on their leases and the freehold of the common parts through their ownership of shares in a management company. The essential distinction is that the commonhold owners are freeholders and not leaseholders. There is thus no inherent limitation on the length of their ownership and no danger of early termination of their ownership through forfeiture. Nevertheless, commonhold has been described as a 'sub-species' of freehold that '*is better seen as a distinct form of land holding*'.[35]

All flat owners must be members of the commonhold association and, on the sale of a commonhold flat, the seller ceases to be a member, with his or her place being taken by the purchaser—that is, the new owner of the flat. Every member of the association is bound by the commonhold community statement, which contains rights and obligations, both positive and negative, to generate a 'local law' for the development. The statement plays the same role as the easements and covenants contained in a standard flat lease, as well as helping to define the relationship between the individual flat owners and the association as owner of the common parts. There will be familiar easements of support and protection, rights of way over, and to use, the common areas and facilities, and for drainage and the passage of services. There will also be obligations similar to the restrictive user covenants found in leases to maintain the ambience and character of the development, and positive obligations to repair individual flats, and to contribute to the cost of repairing and maintaining the common

[34] See Roberts, 'A New Property Term: But No Property in a Term!' [2002] Conv 341.
[35] See Clarke (2002), pp 16–17.

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parts. The difference lies in the fact that these rights and obligations will be contained in a single document, rather than in the individual leases.

Wong explains the central significance of the commonhold association and the commonhold community statement, both of which must follow the form specified in the Commonhold and Leasehold Reform Act 2002 and its regulations.[36]

Wong, 'Potential Pitfalls in the Commonhold Community Statement and the Corporate Mechanisms of the Commonhold Association' [2006] Conv 14, 34

> Under the commonhold concept, the CCS [commonhold community statement] and the CA [commonhold association] are the fundamental organs which provide the statutory and corporate frameworks for the running of the commonhold. Good management in a commonhold would depend on the quality of the execution of these two frameworks in achieving a balance between uniform protection and local flexibility as well as balance between the rule of the majority and protection of minority members.

We now need to consider in a little more detail these essential features.

3.2 CREATION OF COMMONHOLD

Consistent with the drive towards registration, a commonhold development may only exist where the land is (or is to be) registered. There are two routes by which a commonhold may be established: firstly, a new development may be set up as a commonhold development;[37] and secondly, an existing development may be converted from long leasehold to commonhold.[38]

The conversion of an existing development requires the agreement of all of the flat owners within the development where the leases have more than twenty-one years to run.[39] There is a statutory process for the extinction (and the payment of compensation) of shorter-term leases and other interests.[40] Given this need for unanimity, it is unlikely that existing flat developments will be converted to commonhold. Commonhold is a more feasible option for new flat developments.

Where a new development is to be created as a commonhold, there are two stages to the process. Firstly, the developer will need to apply for its freehold estate to be registered as commonhold land, when it will need to submit to the Land Registry the commonhold association's constitutional documents, the commonhold community statement, any necessary consents (e.g. from an existing mortgagee), and the compliance certificate of the association's directors. Upon approval, the estate will be registered as commonhold land, although it is not yet operational as a commonhold community. The commonhold is only activated upon the registration of the first purchaser as the owner of his or her flat when the commonhold community statement comes into force and the commonhold association is registered as the proprietor of the common parts.[41]

[36] The commonhold association's constitutional documents are specified in Schs 1 and 2, and the commonhold community statement in Sch 2.

[37] Commonhold and Leasehold Reform Act 2002, s 7. [38] Ibid, s 9. [39] Ibid, s 3(1)(b).

[40] Ibid, ss 9(3)(f) and 10. [41] Ibid, ss 7(3) and 8.

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3.3 COMMONHOLD LAND OWNERSHIP

Commonhold can only exist where there are at least two units: it is, after all, a form of communal land holding. The individual flats and the common parts are defined by the commonhold community statement, with the common parts defined in a negative fashion as those areas that are not comprised within the flat owners' individual titles.[42] The common parts may be further split between those areas over which all flat owners may exercise rights and those limited-use areas, the user of which may be confined to certain flat owners.[43] Any redefinition of these areas requires the agreement of those affected and the consequent amendment of the commonhold community statement.[44]

It is a fundamental principle that freehold is the only title that can exist within a commonhold development. Smith explains the consequences of what has been called the 'purity of commonhold'.[45]

Smith, 'The Purity of Commonholds' [2004] Conv 194

> [. . .] No conversion of an existing long leasehold development is possible unless 100 per cent of registered lessees, with terms over 21 years of the whole or part of the land, consents. It is not possible to get around this bar, and there is draconian provision for the clearance of all shorter leases of commonhold land. A second aspect of the purity principle is the restriction on the ability of the holder of a residential commonhold unit to grant leases of that unit. Intertwined with this is the issue of diversion by the commonhold association of assessments, on default of the unit holder, from lessees and sub-lessees of rented units.

The second aspect referred to by Smith compromises the fundamental principle of the free alienability of freeholds—but such is the strength of the purity principle that the government was determined that leaseholds should not unduly contaminate a commonhold. Thus, although flat owners within a commonhold are free to sell, mortgage, and charge their flats, they are not able to grant a lease for a premium or for a term greater than seven years, nor are they able to dispose of part of their flat, other than by way of lease, without the consent of the commonhold association.[46]

Commonhold and Leasehold Reform Act 2002

s 15(2) Transfer

(2) A commonhold community statement may not prevent or restrict the transfer of a commonhold unit.

[42] Ibid, s 25. The importance of defining these areas is explained by Van der Merwe and Smith, 'Commonhold—A Critical Appraisal' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005), p 230.

[43] Commonhold and Leasehold Reform Act 2002, s 25(3).

[44] Ibid, ss 23, 24, and 30.

[45] Hansard, HC Vol 627, col 491 (16 October, 2001).

[46] Commonhold and Leasehold Reform Act 2002, ss 21 and 22 A more flexible approach is permitted for non-residential units where there is no statutory prohibition on leases, although control may be imposed through the commonhold community statement: ibid, s 17(5).

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s 17(1) Leasing: residential

(1) It shall not be possible to create a term of years absolute in a residential commonhold unit unless the term satisfies prescribed conditions.

s 20(1) Other transactions

(1) A commonhold community statement may not prevent or restrict the creation, grant or transfer by a unit-holder of—

(a) an interest in the whole or part of his unit;

(b) a charge over his unit.

s 21 Part-unit: interests

(1) It shall not be possible to create an interest in part only of a commonhold unit.
(2) But subsection (1) shall not prevent—

(a) the creation of a term of years absolute in part only of a commonhold unit where the term satisfies the prescribed conditions, [. . .]

(b) the transfer of the freehold estate in part only of a commonhold unit where the commonhold association consents in writing to the transfer.

s 22(1) Part-unit: charging

(1) It shall not be possible to create a charge over part only of an interest in a commonhold unit.

The rationale behind the prohibition of longer leases is a determination to avoid replication of long-lease landholding within commonholds, as well as to discourage absentee landlords. The consequences, however, may be to discourage the choice of commonhold altogether, particularly given the popularity of the buy-to-let market.

The commonhold association, as freeholder of the common parts, is able to dispose of these areas without the consent of the flat owners, but with one important limitation:[47] it cannot charge the common parts except by way of a legal mortgage that has the prior unanimous approval of the flat owners as its members.[48] This freedom seems remarkable, given the crucial importance of the common parts, but may be explained as an attempt to give the commonhold association some freedom of action in the event of possible insolvency.

3.4 THE COMMONHOLD ASSOCIATION

The commonhold association is central to the commonhold scheme. It is simply not possible to have a commonhold without a commonhold association to hold the common parts, and to be responsible for the management of, and the enforcement of rights and obligations within, the commonhold.

Originally, it was envisaged that the association would be a purpose-built association, but the government opted for adapting an existing corporate form—the company limited by

[47] Ibid, ss 27 and 28. [48] Ibid, s 29.

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guarantee, the members of which are the individual flat owners.[49] As such, the association has separate legal personality and limited liability. It is regulated through the Companies Act 2006, with obligations to hold annual general meetings, to file accounts, and to appoint corporate officers to run the association.[50] But the commonhold association is a distinct form of company limited by guarantee and the flat owners have no choice but to be members. Its constitutional documentation is central to the flat owners' relationship with the association, and must incorporate mandatory provisions to try to achieve a fair distribution of power.[51]

Wong, 'Potential Pitfalls in the Commonhold Community Statement and the Corporate Mechanisms of the Commonhold Association' [2006] Conv 14, 26

> The CA [commonhold association] must adopt all the provisions in the model articles – alterations are only permitted for a few articles and any additions must be clearly labelled. These strict rules help to ensure that the democratic nature of the general meeting and director's meeting, which is of particular importance in the context of commonhold, since unit-holders are "captive members" of the particular CA of their building. One underlying threat to democracy is the abuse of the resolutions mechanisms by the developer through his membership or directorship in the CA.

The association operates through two organs: the board of directors and the flat owners in general meeting.

Each flat owner is entitled to single membership in the commonhold association and is entitled to cast a single vote. Co-owners of a flat are required to nominate one of their number to be the association member for their flat and, as such, entitled to vote. There is a principle of equality of representation of each unit, regardless of the value or character of the units within the development. Accordingly, commonhold is more likely to suit those developments in which units are, by and large, uniform in value, size, and type.

The general meeting appoints the directors, who are responsible for the management of the commonhold through their duties to manage and to uphold compliance with the commonhold community statement. The directors need not be flat owners with an interest in the development. Thus professional property management may be achieved either by appointing professional managers as directors, or, alternatively, through the employment of professional managing agents by the directors.

The commonhold association as a corporate vehicle is governed by the rule of the majority. As such, fears have been expressed that a minority of flat owners may be subjected to the 'tyranny' of the majority in decisions that adversely affect their everyday lives within the commonhold community.[52] The vital question is thus whether the mandatory provisions of the association do achieve a fair balance. In particular, the power of the directors to appoint managing agents and to fix the level of service charge without the prior approval of the flat owners in general meeting has drawn criticism.[53]

[49] All unit holders must be members and no person who does not own a unit may be a member.

[50] Directors of the commonhold association may be either appointed by the flat owners from within their own number, or professionals appointed by the flat owners to run the association on their behalf.

[51] See Schs 1 and 2.

[52] See Kenny [2003] Conv 1.

[53] See Wong, 'Potential Pitfalls in the Commonhold Community Statement and the Corporate Mechanisms of the Commonhold Association' [2006] Conv 14.

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The association may be wound up following the standard procedures contained in the Insolvency Act 1986.[54] The flat owners, as members of the association, may initiate winding up voluntarily where it is solvent: for example, should the flat owners wish to redevelop. A compulsory winding-up by court order may occur where the association is insolvent: for example, upon the petition of one or more of its unpaid creditors. In this latter event, the court has power to make a succession order transferring the common parts to a new commonhold association, which will take over the management of the commonhold, unless such an order is 'inappropriate'.[55] A succession order may well be inappropriate unless there is in place some mechanism to clear the debts of the insolvent association.[56] For example, the liquidator of an insolvent commonhold association will be able to pursue defaulting flat owners for any unpaid commonhold assessments, as well as raise further assessments from the flat owners to meet the debts of the association. Thus the limited liability of the flat owners as members of the association could be more fictional than real.[57] It is anticipated that the insolvency of a commonhold association will be an unlikely event, given that it can raise additional funds from the flat owners by levying further assessments, but the possibility exists and has proved of sufficient concern to lenders that they have been hesitant to accept security over commonholds.

3.5 COMMONHOLD COMMUNITY STATEMENT

The commonhold community statement is a crucial document. It sets out '*details of how the community is to run*',[58] in terms of what the flat owners and the commonhold association, respectively, must do, are able to do, or cannot do.

Commonhold and Leasehold Reform Act 2002, s 31

Form and content: general

(1) A commonhold community statement is a document which make provision in relation to specified land for—

(a) the rights and duties of the commonhold association; and

(b) the rights and duties of the unit-holders.

(2) A commonhold community statement must be in prescribed form.

(3) A commonhold community statement may—

(a) impose a duty on the commonhold association;

(b) impose a duty on a unit-holder;

(c) make provision about the taking of decisions in connection with management of the commonhold or any other matter concerning it.

The 2002 Act and its attendant regulations detail what the statement must include by way of mandatory terms and what it may include in optional provisions. The draftsman is provided

[54] Insolvency Act 1986, ss 122 and 124. [55] Ibid, s 51.

[56] See Crabb, 'The Commonhold and Leasehold Reform Act 2002: A Company Law Perspective' (2004) 25 Comp Law 213.

[57] Ibid. [58] Clarke (2002), p 74.

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with a model as a starting point and guide in preparing the statement, which will be a unique document for each development.[59]

Wong explains the format and content of the statement.

Wong, 'Potential Pitfalls in the Commonhold Community Statement and the Corporate Mechanisms of the Commonhold Association' [2006] Conv 14, 19

The CCS [commonhold community statement] is the central property document stipulating the rights and duties of the CA [commonhold association] and the unit-holders. To promote uniform protection, the overall format of the CCS and the contents of its main body are prescribed in the model form in Sch.3 to the Regulations. Part 4 of the main body of the CCS lays down the mandatory "rules" of the commonhold regarding general property rights and duties. These include duty to contribute to assessments and reserve funds (Part 4.2), duty to insure (Part 4.4), duty to maintain and repair (Part 4.5), as well as restrictions on use (Part 4.3), alteration (Part 4.6) and disposition (Part 4.7). In addition to these general provisions, more specific rules are needed to cater for the local needs of a given commonhold. This is achieved by Annex 4 where the developer can insert "local rules" to fine-tune the mandatory rules in Part 4, and by Annex 5 where "supplementary local rules" can be inserted to impose further restraints such as restrictions on keeping pets. In contrast to the mandatory "rules" which can never be amended, "local rules" and "supplementary local rules" can in general be amended by ordinary resolution, with a few exceptions requiring special resolution (and/or consent of the affected unit-holder). The combination of mandatory rules on general property rights and duties and self-prescriptive tailor-made local rules reflects the legislative intention of striking a balance between certainty of protection and local flexibility.

The balance between certainty and flexibility should vary according to the subject matter of the rights and duties. While an individualistic approach is suitable for certain subject matter such as restrictions on use and behaviour, other matters such as the duty to repair and maintain and the duty to insure would require a more prescriptive approach so as to achieve adequate protection for the unit-holders.

The statement is registered against all of the titles within the commonhold, being both the freehold titles to the individual flats and the common parts, and thus will bind the commonhold association and is capable of binding the individual flat owners. The mechanism by which subsequent flat owners are bound is found in s 16 of the 2002 Act.

Commonhold and Leasehold Reform Act 2002, s 16

Transfer: effect

(1) A right or duty conferred or imposed—

(a) by a commonhold community statement, or

(b) in accordance with section 20,

shall affect a new unit-holder in the same way as it effected a former unit-holder.

(2) A former unit-holder shall not incur a liability or acquire a right—

(a) under or by virtue of the commonhold community statement, or

(b) by virtue of anything done in accordance with section 20.

[59] Commonhold and Leasehold Reform Act 2002, Sch 3.

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(3) Subsection (2)—

(a) shall not be capable of being disapplied or varied by agreement, and

(b) is without prejudice to any liability or right incurred or acquired before the transfer takes effect.

Thus both the negative user and alienation provisions, and any positive obligations (including obligations to repair, maintain, insure, and to pay the service charge), are binding on purchasers acquiring a flat in the commonhold development.

3.6 THE MANAGEMENT OF COMMONHOLD

The commonhold community statement will set out the allocation of management responsibilities, and will usually provide that the flat owner will be responsible for the repair, maintenance, and insurance of the interior of his or her flat, while the commonhold association will be responsible for the repair, maintenance, and insurance of the common parts, including the structure of the building and the common facilities.

Commonhold and Leasehold Reform Act 2002, s 14

Use and maintenance [Commonhold Unit]

(1) A commonhold community statement must make provision regulating the use of commonhold units.

(2) A commonhold community statement must make provision imposing duties in respect of the insurance, repair and maintenance of each commonhold unit.

(3) A duty under subsection (2) may be imposed on the commonhold association or the unit-holder.

Commonhold and Leasehold Reform Act 2002, s 26

Use and maintenance [Common Parts]

A commonhold community statement must make provision—

(a) regulating the use of the common parts;

(b) requiring the commonhold association to insure the common parts;

(c) requiring the commonhold association to repair and maintain the common parts.

The cost of repairing, maintaining, and insuring the common parts will be recovered from flat owners by the commonhold association through services charges, which may be made up of three elements: first, the regular day-to-day expenses, which will be calculated according to prepared budgets made by the association; secondly, the levies to a reserve fund to budget over a period for the larger costs of occasional replacement and repair (for example, the painting of the block or the repair of the roof or lifts); and finally, emergency levies to recover unexpected expenditure. The reserve fund is held by the

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commonhold association and may be attached by certain unpaid judgment debtors of the association.[60]

Commonhold and Leasehold Reform Act 2002, ss 38 & 39

Commonhold assessment

38 (1) A commonhold community statement must make provision—

(a) requiring the directors of the commonhold association to make an annual estimate of the income required to be raised from unit-holders to meet the expenses of the association,

(b) enabling the directors of the commonhold association to make estimates from time to time of income required to be raised from unit-holders in addition to the annual estimate,

(c) specifying the percentage of any estimate made under paragraph (a) or (b) which is to be allocated to each unit,

(d) requiring each unit-holder to make payments in respect of the percentage of any estimate which is allocated to his unit, and

(e) requiring the directors of the commonhold association to serve notices on unit—holders specifying payments required to be made by them and the date on which each payment is due.

[....]

Reserve fund

39 (1) Regulations under section 32 may, in particular, require a commonhold community statement to make provision—

(a) requiring the directors of the commonhold association to establish and maintain one or more funds to finance the repair and maintenance of common parts;

(b) requiring the directors of the commonhold association to establish and maintain one or more funds to finance the repair and maintenance of commonhold units.

(2) Where a commonhold community statement provides for the establishment and maintenance of a fund in accordance with subsection (1) it must also make provision—

(a) requiring or enabling the directors of the commonhold association to set a levy from time to time,

(b) specifying the percentage of any levy set under paragraph (a) which is to be allocated to each unit,

(c) requiring each unit-holder to make payments in respect of the percentage of any levy set under paragraph (a) which is allocated to his unit, and

(d) requiring the directors of the commonhold association to serve notices on unit-holders specifying payments required to be made by them and the date on which each payment is due.

[60] Ibid, s 39(4).

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Each flat owner must contribute the percentage of these costs that is allocated to his or her flat by the commonhold community statement. The commonhold association has no special powers to recover unpaid service charges beyond the usual dispute resolution process to be considered shortly.

Proposals for the association to be given a right to secure unpaid assessments by charge were rejected by the government, which wished to avoid any suggestion that the freeholds within a commonhold scheme could be effectively forfeited by the process of charge and subsequent sale.[61] This has led to criticisms that the association has no effective means by which to ensure that the costs of management are met by all of the flat owners.[62] There is the danger that effective management will be compromised and that, to maintain the necessary flow of funds, compliant flat owners will have to pick up the shortfall.

The association is obliged to ensure that the flat owners observe the obligations imposed by the statement. As we have seen, these obligations are extensive and cover not only the payment of service charges, but also negative obligations relating to user of both individual flats and the common parts, as well as positive obligations regarding the repair and maintenance of individual flats. The 2002 Act does, however, recognize that living in a community requires give and take, so that it may not be to the overall benefit of that community for enforcement action to be taken against all breaches. The association is thus granted a right of inaction where it reasonably believes that doing nothing will promote harmonious relationships.

Commonhold and Leasehold Reform Act 2002, s 35

Duty to manage

(1) The Directors of a commonhold association shall exercise their powers so as to permit or facilitate so far as possible—

(a) the exercise by a unit-holder of his rights, and

(b) the enjoyment by each unit-holder of the freehold estate in his unit.

(2) The directors of a commonhold association shall, in particular, use any right, power or procedure conferred or created by virtue of section 37 for the purpose of preventing, remedying or curtailing a failure on the part of a unit-holder to comply with a requirement or duty imposed on him by virtue of the commonhold community statement or a provision of this Part.

(3) But in respect of a particular failure on the part of a unit-holder (the 'defaulter') the directors of a commonhold association—

(a) need not take action if they reasonably think that inaction is in the best interest of establishing or maintaining harmonious relationships between all unit-holders, and that it will not cause any unit-holder (other than the defaulter) significant loss or significant disadvantage, and

(b) shall have regard to the desirability of using arbitration, mediation or conciliation procedures (including referral to a scheme approved under section 42) instead of legal proceedings whenever possible.

[61] The association may enforce a judgment debt by way of charging order, but will rank behind other existing secured creditors: see Chapter 28, section 4.4.

[62] See Clarke (2002), p 143.

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3.7 DISPUTE RESOLUTION

Traditional court processes are ill equipped to deal successfully with disputes between neighbours, in relation to whom the maintenance of a continuing working relationship is so important, and an economic and timely response is necessary. Although no distinct statutory dispute resolution system is introduced by the 2002 Act, it is envisaged that the court process will be used as a last resort or where decisive action is needed.[63]

Clarke explains the hope that disputes will be resolved through alternative means.

Clarke, *Commonhold: The New Law* (2002, p 151)

> There is [...] no statutory system for the resolution of disputes. Instead of such a statutory system, the CLRA [Commonhold and Leasehold Reform Act] 2002 envisages a staged response. Although much will depend on regulations and rules to be introduced later, it is envisaged that the [...] CCS [commonhold community statement] will set out an internal complaints procedure which members must first adopt. The dispute resolution procedures then involve an inter-relationship of three approaches after any such internal procedures have been exhausted. There is specific provision for regulations to provide that a commonhold association shall be a member of an approved Ombudsman scheme. There is a general statutory duty on the directors of a commonhold association to have regard to the desirability of using arbitration, mediation or conciliation procedures (including referral under approved Ombudsman schemes), instead of legal proceedings. Finally, the courts will have an overriding jurisdiction

4 CONCLUSION

Flat ownership presents a complex challenge to devise a legal framework that will effectively balance the freedom of individual ownership against the compromise necessary for communal living. The last two decades have seen considerable legislative activity: firstly, to provide an effective framework for the enforcement of leasehold covenants; secondly, to try to overcome the considerable shortcomings of the long-lease system of flat ownership; and thirdly, to introduce an alternative form of communal land holding—the commonhold. Areas of reform are still outstanding, with the enforcement of freehold positive obligations through the land obligations still awaiting the statute book.[64]

The question is whether commonhold will remain merely an alternative, or will it render the long lease system obsolete? Commentators have suggested that commonhold should be sufficiently attractive to sideline the long lease of flats—but only after the legislation has been refined to overcome deficiencies.[65] We have noted some of those deficiencies above, but particular cause for concern arises from the obstacles to converting existing long-lease

[63] See Commonhold and Leasehold Reform Act 2002, Sch 3, s 35(3)(b) extracted above, and s 42.

[64] See Chapter 26, section 5.

[65] See Clarke, 'The Enactment of Commonhold: Problems, Principles and Perspectives' [2002] Conv 349; Davey, 'The Regulation of Long Residential Leases' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005) ch 10; Van Der Merwe and Smith, 'Commonhold: A Critical Appraisal' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005, ch 11); Wong, 'Potential Pitfalls in the Commonhold Community Statement and the Corporate Mechanisms of the Commonhold Association' [2006] Conv 14.

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developments, the difficulties of accommodating mixed developments given the inflexibility of equality of voting and service charge allocation, the constraints of adapting an existing corporate vehicle to the commonhold association—particularly, the provisions governing insolvency and the weak mechanisms for recovery of service charges. Last, but not least, are doubts that commonhold really is freehold, given the limitations of alienability and the inevitable constraints of the commonhold community statement, which bridges the 'threefold unity' between individual units, the common parts, and the association.

Clarke, writing in 2002,[66] shortly after the passing of the Commonhold and Leasehold Reform Act, foretold a 'bright future' for commonhold—but already he doubts his prediction.

Clarke, 'Long Residential Leases: Future Directions' in *Landlord and Tenant Law: Past, Present and Future* (ed Bright, 2006, p 181)

> However Part I of the Commonhold and Leasehold Reform Act 2002, for all the assurances that it was a fine piece of legislation, contains some fundamental flaws that will prevent its widespread adoption for both large and mixed residential estates and developments. Indeed, these inadequacies are proving so fundamental to the key players (developers and lenders) that commonhold will possibly be consigned to the margins. There were, by 27 September 2005, only five commonholds registered a year after commonhold was brought into force, and they all are small homogeneous developments.
>
> [...] [I]f nothing is done, at best commonhold will be peripheral, at worst it will be largely irrelevant, to the solution of developing homes for the future. For it to have a major role, there would need to be primary legislation to deal with lenders' concerns regarding liquidation of the commonhold association. Less than half the members of the Council of Mortgage Lenders are currently willing to lend on commonhold titles, and some of the big lenders are included in these numbers. Such primary legislation could also tackle the other shortcomings [...] Yet even if the major concerns were satisfactorily addressed by primary legislation, there is no certainty that commonhold would be widely adopted in preference to long leases [...] there is the preference for the familiar. Even if the factors governing the choice between commonhold and long leasehold for new developments were entirely neutral, it is likely that many developers would still opt for the familiar [...] Accordingly, there must be good reason positively to choose commonhold, even if the technical difficulties and statutory gremlins outlined are overcome. Primary legislation to encourage or even require the use of commonhold in preference to long leases is always a long term possibility [...] Yet it is hard to envisage any Government being willing to take any steps in such a direction, until it is satisfied that commonhold is fit for the purposes for which it was enacted.

Clarke mentions the reluctance of developers and lenders to embrace commonhold, but flat owners must not be forgotten: after all, developers and lenders will be more inclined to overcome, and government to address, those concerns if flat owners demand commonhold over long leases.

Both systems are complicated and difficult for flat owners to understand, and neither can solve the friction that communal living can bring. The bottom line is that most flat owners see little distinction between commonhold and long leases, where a management company owns the freehold that the flat owners control. Indeed, the differences are largely of legal

[66] 'The Enactment of Commonhold: Problems, Principles and Perspectives' [2002] Conv 349.

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detail. Commonhold may still win over the long lease held from an independent landlord, but, even here, enfranchisement and the right to manage has narrowed the score.

QUESTIONS

1. Why is it difficult to achieve the freehold ownership of flats?
2. How successful do you think the long leasehold system of flat ownership has been?
3. What are the current deficiencies in commonhold, as it has been enacted in the Commonhold and Leasehold Reform Act 2002?
4. Is there a pressing need for commonhold?

FURTHER READING

Blandy, Dupuis and Dixon, *Multi-owned Housing: Law, Power and Practice* (Aldershot: Ashgate, 2010)

Clarke, *Commonhold: The New Law* (Bristol: Jordans, 2002)

Clarke, 'Long Residential Leases: Future Directions' in *Landlord and Tenant Law: Past, Present and Future* (ed Bright, Oxford: Hart, 2006, ch 9)

Clarke, 'Occupying 'Cheek by Jowl': Property Issues Arising from Communal Living' in *Land Law: Themes and Perspectives* (eds Bright and Dewar, Oxford: OUP, 1998)

Clarke, 'The Enactment of Commonhold: Problems, Principles and Perspectives' [2002] Conv 349

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PART H

SECURITY RIGHTS

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SECURITY INTERESTS IN LAND

CENTRAL ISSUES

1. Securing the repayment of money may be achieved by the grant of a legal or equitable interest in land, giving the creditor a right of recourse. For example, such a right may allow a lender to sell a borrower's freehold or lease if the debtor fails to repay the creditor.
2. There are four types of security interest: the pledge, the lien, the mortgage, and the charge. A lien, mortgage, or charge may be created over land.
3. The legal charge by way of mortgage of land is a hybrid form of security, being, in form, a charge, but granting the lender the rights associated with a mortgage.
4. If the borrower has a legal estate or equitable interest in land, a creditor can acquire an equitable security interest by means of a mortgage or a charge.
5. The equity of redemption represents the borrower's interest under a traditional mortgage of property. It has been of central importance to equity's protection of borrowers, but its continued utility, in a case in which the lender is granted a legal charge, is questionable.
6. The provision of secured credit is fundamental to modern living and commercial life, and lawyers have proved adept at creating different forms of security to cater for a wide variety of circumstances.

1 INTRODUCTION

In this chapter, we are concerned with the use of land (or legal and equitable property rights relating to land) as security for the repayment of money by a borrower to a lender. The lender acquires security by *being granted* a distinct legal or equitable property right in the land. This gives the lender a number of rights to which it can resort if the borrower fails to repay the loan. Crucially, because it has a legal or equitable property right in the land, the lender may also be able to assert its security right not only against the borrower, but also against third parties.

Sir Nicholas Browne Wilkinson VC accepted the following definition of security.

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Bristol Airport plc v Powdrill
[1990] Ch 744, CA

Sir Nicolas Browne-Wilkinson VC

At 760

Security is created where a person ('the creditor') to whom an obligation is owed by another ('the debtor') by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtor's obligation to the creditor.

There are, thus, two elements to a security transaction: firstly, the loan made by the lender to the borrower; and secondly, the creation of the proprietary interest by the borrower to the lender to secure the repayment of the loan. We commonly call that proprietary interest a 'mortgage', but, as we shall see, we need to be careful of our terminology when dealing with security interests. The loose use of terms can, and often has, caused confusion.

In this chapter, we will look first at why proprietary (or what are sometimes called 'real') security interests are so popular with lenders today; we will then explore the different types of proprietary security interest, before examining the development and particular nature of security interests over land. In Chapter 29, we will turn our attention to the loan contract and the controls that the law has imposed to protect the borrower. Finally, in Chapter 30, we will focus on the rights and powers conferred upon the lender to enforce its security over land.

2 THE ROLE AND IMPORTANCE OF SECURITY

Secured lending in both the domestic and commercial spheres is prolific and an important indicator of economic conditions. Bank of England Trends in Lending statistics revealed that the net average monthly flow of lending to UK businesses was £3.9 billion during 2008, but had fallen by 2010, in the light of poor economic conditions and reluctant bank lending, to a net average monthly flow of £2.1 billion.[1] Figure 26 shows that domestic mortgage lending has also fallen from 2008. Nevertheless the amount of lending remains in the billions.

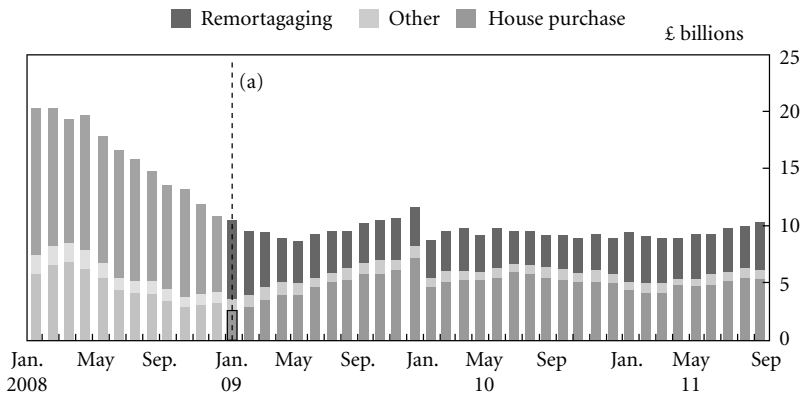

Figure 26 Mortgage lending by the major UK lenders[(a)]
Note: (a) the pre 2008 data is estimated

[1] Showing that businesses had repaid more than they had been able to borrow.

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In the domestic market, policies by all political parties since the mid-twentieth century have promoted home ownership, through the ready availability of mortgage finance, to reduce public expenditure on housing, and to enhance social and political stability.[2]

Oldham, 'Mortgages' in *Land Law: Issues, Debates Policy* (ed Tee, 2002, p 172)

> [. . .] [P]roperty ownership effects a form of special inclusion or community bonding. The purchase of a house affiliates the mortgagor to a particular locality and to a particular social group. The purchaser acquires a sense of belonging not only to the neighbourhood in which the house is located, but also to a larger group of homeowners generally. Home ownership signals respectability, responsibility and, usually, also upward mobility. The particularly English ideology surrounding home-ownership has had the result that non-homeowners have become almost second-class citizens.

Most people aspire to the economic and social advantages that are associated with home ownership, but they can only attain those advantages by borrowing from a financial institution. Instead of paying rent for their accommodation, they repay their mortgage by instalments, in the expectation that they will not only enjoy the use of their home, but also be able to reap the benefits of an increase in its capital value as property prices increase—a bonus that is unavailable to a tenant.

The availability of credit is also vital to business and the economy, particularly to promote the growth of small and medium-sized businesses. Banks and other financial institutions are more ready to lend, and offer less onerous terms, where the risks associated with non-payment are reduced by the availability of security.

Oldham describes this economic significance.[3]

Oldham, 'Mortgages' in *Land Law: Issues, Debates Policy* (ed Tee, 2002, p 169)

> In terms of function, mortgages constitute a key economic institution—the means by which assets are mobilised, capital generated and productivity and the wider economy boosted. The mortgage is a mechanism that transforms 'passive 'land value into active value in that it allows the value of land to be released for other purposes while the freeholder or leaseholder is still able to enjoy the benefits of physical occupation or possession. It has even been argued that the ability to mortgage land is the key to the fundamental distinction between rich and poor countries. In poor countries, assets mobilisation is not possible because the capital invested in housing is incapable of being released because of inadequate underlying structures of property ownership and of social, political and legal control.

Clarke and Kohler have summarized the functions of secured credit as five-fold. As argued in the extract below, a security interest can give a lender: (i) a right of first recourse; (ii) priority; and (iii) the opportunity for non-judicial enforcement of the borrower's duties. Security interests can also serve: (iv) a hostage function; and (v) as a means of signalling the

[2] See also Gray and Gray, *Elements of Land Law* (5th edn, 2009), [6.1.3]–[6.1.5] for some of the social and political effects of mortgage finance.

[3] See also the Law Commission Consultation Paper No 176, *Company Security Interests* (2004), [1.16]–[1.18].

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creditworthiness of the borrower, and allowing the lender to monitor and control the borrower's behaviour.

Clarke and Kohler, *Property Law: Commentary and Materials* (2005, p 659)

18.1.2.1 Right of first recourse

First, security over an asset gives the security interest holder the right of first recourse to it. If there is default in repayment, the secured creditor can sell the asset and obtain repayment out of the proceeds of sale in priority to anyone else (except someone with a prior ranking security interest over the same asset). Most importantly, this applies even if the debtor goes bankrupt. A secured creditor is largely unaffected by the bankruptcy or liquidation of its debtor: its power to sell is generally not restricted in any way. If there is a surplus left after it has done so, that goes into the general pool of assets to be divided among the unsecured creditors. So, in any bankruptcy or liquidation, unsecured creditors are paid just a fraction of what they are owed (almost invariable a tiny fraction) whereas secured creditors are paid in full (assuming the secured asset was worth more than the total indebtedness).

This is not only a good thing in itself, as far as the secure creditor is concerned. It also dramatically reduces the risk in lending. Provided the lender ensures that there is a sufficient margin between the value of the asset it accepts as security and the amount it lends, its return of capital is more or less guaranteed.

18.1.2.2 Attachment to the asset

Since security interests are property interest in the secured asset, they are attached to the asset, in the sense that the asset owner cannot sell the asset free from the security interest unless he either pays off the debt or obtains the lender's consent. If he does neither, the security interest will be fully enforceable against the buyer (subject to the [appropriate] enforceability rules). This does not make the buyer personally liable for the debt, but it does entitle the security interest holder to sell the asset and recoup the debt out of the proceeds, handing back to the buyer only whatever is left after that.

18.1.2.3 Non-judicial enforcement

The security interest holder's primary remedy [. . .] is to sell the secured asset, and in most cases to do so without first obtaining a court order, or going through any other formal procedure. It does not even have to sell by auction: the sale will be an ordinary private sale. This ability to enforce security by a simple self-help process is uncommon in other jurisdictions. It has considerable attraction to lenders. It means that the lender does not have to satisfy anyone in advance that default has justified enforcement [. . .], there is no public scrutiny of the conduct of the sale or the price obtained, and no time-consuming, costly court process to go through [. . .]

18.1.2.4 The hostage function

[. . .] Security acts as a hostage, providing an incentive to the borrower to comply with the loan agreement. If the lender takes security over an asset that the borrower values highly, fear of losing the asset will induce the borrower to go to greater lengths than it might otherwise have done to keep up the payments. When money is short, it will make these repayments before paying other debts, and it will hesitate before engaging in risky behaviour which might

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endanger its ability to repay [. . .] This helps to explain why lending money on the security of peoples' homes is such good business [. . .]

18.1.2.5 Signalling, monitoring and control

A debtor who offers a valued asset as security can be said to be signalling his confidence that he will be able to repay, thus lessening the need for the lender to engage in expensive checks on his creditworthiness. If the asset has a predictable market value which is greater than the proposed loan, the creditor has even less need to check creditworthiness [. . .]

[. . .] [S]ecurity can also be used as a means of enabling the lender to monitor the behaviour of the borrower. The terms of a security interest over assets will usually require the borrower to maintain the value of the secured asset by keeping it in good state of repair, to insure it [. . .] and notify the lender of any event threatening the value of the secured asset or the ability of the borrower to repay. In this country bank loans to businesses are usually secured by security interests taken over all the assets of the business. This not only gives the lender access to comprehensive information about the running of the business, but also gives the lender the opportunity to exercise a significant level of control over decision-making, as well as enabling the lender to take early action to safeguard its interests.

It is easy, however, to be beguiled into overvaluing security interests, as opposed to the underlying debt that they secure. Clarke makes the following point.

Clarke, 'Security Interest in Property' in *Property Problems From Genes to Pension Funds* (ed Harris, 1997, p 122)

[. . .] [T]he value to the mortgagee *of the mortgage* fluctuates depending on the likelihood of the mortgagor repaying the debt in full and in time with—paradoxically—the value of the mortgage decreasing as the likelihood of default decreases.

She also notes that '*security interests start to look distinctly marginal as property interests*'[4] when one recognizes that a security interest generally confers rights of recourse only if the debt is not repaid—an event that lies solely within the control of the borrower.

Nevertheless, the taking of security has considerable advantages for the lender, which may, in part, be passed onto the borrower (e.g. through lower interest rates), but if one party has a security interest, this is clearly disadvantageous to the borrower's other, unsecured creditors—particularly in the event of the borrower's insolvency. As a result, the probity and overall efficiency of secured credit has been questioned.[5]

Clarke and Kohler summarize some of these arguments.[6]

[4] Clarke, 'Security Interest in Property' in *Property Problems From Genes to Pension Funds* (ed Harris, 1997), p 123.

[5] See Finch (1992) 62 MLR 633 and Mokal (2002) 22 OJLS 686, who refer to the extensive US literature on this question, which considers the utility of security rights not only in relation to land, but also in relation to other rights held by a borrower or debtor. See also Getzler, 'The Role of Security Over Future and Circulating Capital: Evidence from the British Economy circa 1850–1920', *Company Charges: Spectrum and Beyond* (eds Getzler and Payne, 2006), ch 10.

[6] See also Clarke (1997), p 124.

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Clarke and Kohler, *Property Law: Commentary and Materials* (2005, p 661)

> Intuitively, it seems likely that it is, because it has been so pervasive in market economies for such a long time [...] But efficient for whom? It seems fairly obvious that it is efficient for the secured creditor, in that the risk of not recovering the loan in full is decreased. This should result in lenders charging a lower rate of interest for secured loans, which suggests that secured credit is more advantageous for borrowers as well. However, whilst the risk of not being repaid in full is decreased for the secured creditor, it is correspondingly increased for all the unsecured creditors of the same debtor, because the secured assets are removed from the pool of assets out of which they can be repaid. So at best, unsecured creditors will increase the rate of interest they charge the debtor by an amount corresponding to the discounted rate charged by the secured creditor and secured credit then becomes a "zero sum game". Even in such a case, the outcome is likely to be inefficient rather than neutral because setting up security arrangements is costly, so the debtor's total credit bill [...] will be greater in a world where secured credit is permitted than it would be in a world where it is prohibited. At worst—and this is rather more in line with what actually happens in the real world—some unsecured creditors will be unable to respond to the granting of secured credit by raising their interest rates (because they are involuntary creditors, or are not in a position to negotiate or re-negotiate the terms on which they extend credit). This benefits the debtor, but it does mean that the advantages to the debtor and the sophisticated and relatively affluent creditor are bought at the expense of the relatively poor and unsophisticated creditor [...]
>
> However, there are other benefits that secured lending brings. We have already noted the monitoring and control functions that security enables the creditor to undertake can benefit everybody [...] Whether, these advantages outweigh the disadvantages remains a matter of debate.

The unsecured creditor is in a particularly vulnerable position where the secured asset represents all (or the mammoth share) of the debtor's wealth, because the creditor will be left with nothing (or little) against which he or she can seek recovery.

Clarke notes the impact of the secured creditor's privileged position on inhibiting the use and development of insolvency regimes.[7]

Clarke, 'Security Interest in Property' in *Property Problems From Genes to Pension Funds* (ed Harris, 1997, pp 122–3)

> This virtual isolation of the secured creditor from the bankruptcy process has a profound effect on the development of bankruptcy law in this country in at least two respects. First, it has significantly hampered the development of a workable business rescue procedure [...] Even more significantly, but less often publicly acknowledged, the secured creditor's aloofness from the bankruptcy process has made bankruptcy virtually unusable for individuals whose only significant asset is a mortgaged house.

[7] Since Clarke was writing, administration has been promoted as a collective corporate rescue regime, but one in which the secured creditor continues to play a pre-eminent role: see Enterprise Act 2002, amending Insolvency Act 1986, Sch BI.

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3 GENERAL FORMS OF SECURITY

Millett LJ identified the forms of security interest found in English law as follows.

Re Cosslett Contractors Ltd
[1998] Ch 495

Millett LJ

At 508

There are only four kinds of consensual security known to English law: (i) pledge; (ii) contractual lien; (iii) equitable charge and (iv) mortgage. A pledge and a contractual lien both depend on the delivery of possession to the creditor. The difference between them is that in the case of a pledge the owner delivers possession to the creditor as security, whereas in the case of a lien the creditor retains possession of goods previously delivered to him for some other purpose. Neither a mortgage nor a charge depends on the delivery of possession. The difference between them is that a mortgage involves a transfer of legal or equitable ownership to the creditor, whereas an equitable charge does not.

In this extract, Millett LJ sets out the *general* forms of security right that can apply even where no land is involved. In the remainder of this section, we will consider these four forms of security right. In section 4 below, we will focus on the security interests that are particularly important where land is concerned.

3.1 THE PLEDGE

The pledge is the most traditional form of security. It is dependent upon the borrower delivering possession or control of property to the lender. Ownership in the property is retained by the borrower and the lender obtains its own property right (a 'special interest' in the property), entitling it to sell if the loan is not repaid, accounting to the borrower for the proceeds of sale over and above that required to repay the loan.[8]

A pledge is found in a wide variety of situations, from pawn-broking, to international finance and trade. Its strength lies in the protection that it can afford the lender: by taking control of the property, the lender can assert its priority against the claims of other creditors. The disadvantage of a pledge lies in the fact that physical possession or control of the property must be delivered to the lender so that the borrower is deprived of the use of the property. Chattels, being moveable assets, lend themselves to the essential possessory nature of the pledge. Documents that constitute the title to goods, money, and other investments may also be pledged.[9] Given its immovable nature, land does not form the natural subject matter of a pledge—although the original forms of security over land tried to replicate the nature of a pledge.[10]

[8] *The Odessa* [1916] 1 AC 145; *Matthew v TH Sutton* [1949] 4 All ER 793.

[9] For example, bills of lading, negotiable instruments such as cheques, promissory notes, treasury bills, and bills of exchange.

[10] The name 'mortgage' is derived from the medieval word for pledge: the 'gage'.

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3.2 THE LIEN

As Millett LJ points out, a consensual lien operates as a legal form of security: for example, a borrower can agree with a lender that the lender has a right to retain possession of property until the borrower's outstanding debt is paid. In addition, the common law has also implied liens into certain contracts: for example, a repairer of property is entitled to a lien to secure the costs of repair.[11]

An equitable lien gives a lender an equitable property right, rather than a legal property right. The rules relating to the content and acquisition of an equitable lien therefore differ from those applying to a common law lien. As to its *content*, an equitable lien is in the nature of a charge: it does not require the lender to have possession. As to its *acquisition*, an equitable lien can only arise by operation of law, rather than as a result of the agreement of the parties.

The most significant equitable lien for our purposes arises upon the sale of land and is called the 'unpaid vendor's lien'. A vendor who has transferred his or her freehold or lease to the purchaser, but has not received the full purchase price, is entitled to claim an equitable lien (over the freehold or lease now held by the purchaser) to secure the unpaid portion. Likewise, a purchaser who has paid, or partly paid, the purchase price for land, but has not yet received the vendor's freehold or lease, may have a power (for example, because of a breach of the contract of sale by the vendor) to pull out of the contract and claim back any payment that he or she has made. In such a case, the purchaser has an equitable lien over the vendor's freehold or lease in order to secure the vendor's duty to repay that money.

3.3 THE MORTGAGE

Buckley LJ has described the form of a mortgage as follows.[12]

Swiss Bank Group v Lloyds Bank Ltd
[1982] AC 584, HL

Buckley LJ

At 594

The essence of any transaction by way of mortgage is that a debtor confers upon his creditor a proprietary interest in property of the debtor, or undertakes in a binding manner to do so, by the realisation or appropriation of which the creditor can procure the discharge of the debtor's liability to him, and that the proprietary interest is redeemable, or the obligation to create it is defeasible, in the event of the debtor discharging his liability. If there has been no legal transfer of a proprietary interest but merely a binding undertaking to confer such an interest, that obligation, if specifically enforceable, will confer a proprietary interest in the subject matter in equity. The obligation will be specifically enforceable if it is an obligation for the breach of which damages would be an inadequate remedy. A contract to mortgage property, real or

[11] Other common law liens include an innkeeper's (or hotelier's) and carrier's lien. Liens may also arise from the general usage of a particular trade or business: e.g. solicitors, factors, bankers, stockbrokers, and insurance brokers.

[12] Buckley misuses the term 'an equitable charge' in the last line of this extract. He should have referred to 'an equitable mortgage'.

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personal, will, normally at least, be specifically enforceable, for a mere claim to damages or repayment is obviously less valuable than a security in the event of the debtor's insolvency. If it is specifically enforceable, the obligation to confer the proprietary interest will give rise to an equitable charge upon the subject matter by way of mortgage.

A mortgage thus transfers the borrower's interest in the property to the lender, subject to an obligation on the lender to return that interest to the borrower once the debt is repaid—an obligation that confers upon the borrower what is known as 'a right to redeem'. The borrower's legal right to redeem is governed by the need for strict compliance with the repayment terms set out in the loan agreement. But equity will recognize the borrower's continuing equitable right to redeem even if he or she has failed to repay the loan in accordance with the contractual terms. This equitable right to redeem is of such import that it is recognized as giving the borrower an equitable property right: a right that is capable of binding third parties. In Chapter 5, section 1, it was suggested that equitable property rights depend on one party being under a duty to another; the equitable right to redeem is based on the lender's duty to transfer a mortgaged right back to the borrower if the underlying debt is repaid. Thus, although the mortgagee has the legal title to the property, a mortgage differs from an outright sale, because the lender's title is subject to the borrower's equity of redemption, the economic value of which is represented by the value of the property less the amount required to repay the lender. In this rather roundabout fashion, the security nature of the mortgage is achieved. We will have more to say about the borrower's equity of redemption in section 5 below.

The lender's inherent rights under a legal mortgage are defined, firstly, by their ownership of the legal title, which confers a right to possession, and secondly, by their right to apply to bar the borrower's equitable right to redeem, and thus extinguish the equity of redemption, by a process known as 'foreclosure'.

As Buckley LJ indicates, mortgages may take a legal or equitable form. A mortgage will be equitable where the borrower has only an equitable interest in the property and transfers that interest to the lender, or where the formalities used to create the mortgage fall short of the requirements to convey the legal title,[13] but nevertheless are recognized as an agreement to create a mortgage, and so give the lender an equitable property right under the doctrine of anticipation (see Chapter 9 and section 4.3 below).

3.4 THE CHARGE

Millett LJ, again in *Re Cosslett Contractors*, defined a charge as follows.

Re Cosslett Contractors Ltd
[1998] Ch 495, CA

Millett LJ

At 508

It is of the essence of a charge that a particular asset or class of assets is appropriated to the satisfaction of a debt or other obligation of the chargor or a third party, so that the chargee

[13] See Chapter 7.

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is entitled to look to the asset and its proceeds for the discharge of the liability. This right creates a transmissible interest in the asset. A mere right to retain possession of an asset and to make use of it for a particular purpose does not create such an interest and does not constitute a charge.

A charge creates a new proprietary interest that encumbers or burdens the borrower's ownership of the property. In contrast to a mortgage, there is no transfer of an existing ownership interest. The charge entitles the lender to look to the charged property to satisfy the debt. In the absence of any express or implied powers contained in the charge, the lender does so by applying to court for an order for the sale of the property, or for the appointment of a receiver to apply the capital or income from the property (as appropriate) in repayment of the debt. Upon satisfaction of the debt, the charge is automatically discharged, because there is simply no continuing debt to be met out of the property. The charge resembles the Roman law *hypothec*; indeed, it is sometimes described as a 'hypothecation'.

The charge is a creature of equity, although the Law of Property Act 1925 (LPA 1925) also uses the term 'charge' to describe a special form of legal interest that can be used to give a lender a security right in land.[14] It is important to distinguish the equitable charge (which can apply even where land is not involved) from the legal charge created by the 1925 Act (which can apply only to land). An equitable charge may be taken over existing and future property, and may be *fixed* over specific property or taken in *floating* form over a changing fund of assets. For example, one of the most common forms of commercial security is the floating charge over all of the rights, whether present or future, of a company. The floating charge affects the assets for the time being owned by the company, yet permits the company to deal with those assets in the ordinary course of the company's business without the consent of the lender. A floating charge may be converted to a fixed charge, by a process known as 'crystallization', which will occur either where the company is no longer able to deal with its assets in the ordinary course of its business—because, for example, it has entered one of the corporate insolvency regimes—or where the parties have agreed that crystallization should be triggered by certain events.

The categorization of fixed and floating charges has been the source of much litigation, but has been finally settled by the House of Lords, which identified the defining factor as the degree of control that the lender exercises over the charged asset.[15]

Re Spectrum Plus Ltd
[2005] 2 AC 680, HL

Lord Walker

At [138]–[139]

Under a fixed charge the assets charged as security are permanently appropriated to the payment of the sum charged, in such a way as to give the chargee a proprietary interest in

[14] See section 4.2 below.

[15] See also Worthington, 'Floating Charges: The Use and Abuse of Doctrinal Analysis' in *Company Charges: Spectrum and Beyond* (eds Getzler and Payne, 2006), ch 3. The analysis of the House of Lords in *Re Spectrum Plus* [2005] 2 AC 680, HL, essentially matches that of Worthington in *Proprietary Interests in Commercial Transactions* (1996), pp 78–86.

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the assets. So long as the charge remains unredeemed, the assets can be released from the charge only with the active concurrence of the chargee. The chargee may have good commercial reasons for agreeing to a partial release. If for instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate (another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself.

Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a *fund* of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business.

4 FORMS OF SECURITY OVER LAND: MORTGAGES AND CHARGES

The English mortgage has been described as *'a work of fiction' and 'a confusion of things'*.[16] To understand that fiction, we must look to the development of the form of English mortgage, bearing in mind the general forms of security interest examined in section 3 above.

4.1 DEVELOPMENT OF MORTGAGES OF LAND

Mortgages have a long history, which was much influenced by the laws against usury that prohibited the charging of interest.[17]

Baker, *An Introduction to English Legal History* (4th edn, 2002, p 311)

From the earliest times, debtors have used property as security—or 'gage'—for loans of money. Whether the gage was a chattel or land, possession had to be handed over to the lender, to be returned on payment. In some early forms of gage no term was fixed: the gagee held the property until he was satisfied. Another early form, [. . .], was a lease of years to the gagee, the term being the period of the loan. If the gagee took the profits in reduction of the loan, this was known in early times as a living gage (*vivum vadium*) apparently because the property continued to work for the borrower; but if the lender took the principal as well as the profits, it was a dead gage ('mortgage') and the arrangement, though sinful as giving the lender a usurious return, was legally valid. By the fifteenth century, however, the name 'mortgage' has apparently come to be used for any arrangement whereby a loan was secured by a conveyance of real property. The self redeeming living gage had long since gone into disuse: it cast on the lender the responsibility of refunding himself, perhaps without profit, and it was less attractive than a passive security in the form of land which would become the lender's absolutely if the borrower failed to pay on time. Two new ways of effecting such a security were developed in the thirteenth century: either the mortgagor leased the land for years to

[16] Watt, 'Mortgage Law as Legal Fiction' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2007), pp 73 and 76.

[17] The laws against usury were not finally abolished until the Usury Laws Repeal Act 1854.

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> the mortgagee, with a proviso that if the debt was not paid by a certain date the mortgagee would have the fee, or the mortgagor conveyed the fee to the mortgagee forthwith, on condition that he might re-enter (and regain the fee) if he paid by a certain date [. . .] The second form gave the mortgagee a fee simple defeasible by condition subsequent (that is, payment). One advantage of this fee simple mortgage was that it was arguably non-usurious [. . .] In the seventeenth century a further alternative device came into almost universal use, the long term of years with clause for defeasance [. . .] and it later became a common practice under the common law forms of mortgage [. . .] to allow the mortgagor to remain in possession as a tenant at will or at sufferance of the mortgagee. After 1600 the mortgage deed might contain express provision for this, but the practice is probably older.

We can, thus, see that the lawyers of old utilized both the pledge and the mortgage as security devices, although it was the classic mortgage by conveyance or demise that prevailed. The 'fiction' referred to lies in the fact that, at common law, the *lender* was the owner of the property and so entitled to the incidents of ownership—in particular, possession—while the borrower held only a right to insist on reconveyance of the legal title upon repayment of the debt. This was despite the fact that, as the laws against usury relaxed and the charging of interest was permitted, the lender had no wish to take possession unless and until the borrower failed to repay the loan. Despite the position at common law, the borrower generally kept possession of the property and both parties saw him or her as its true owner. It was the borrower's equity of redemption that redressed the balance somewhat: equity's protection of the borrower's right to repay the debt and redeem the property resulted in the borrower (in effect) being regarded as the owner in equity, with the lender's legal title being held only by way of security.

The LPA 1925 introduced the current incarnation of the legal charge by way of mortgage. This special security interest, existing only in relation to land, allows a borrower with a freehold or lease to give the lender a legal interest by way of security *without* needing to transfer his or her freehold or lease to the lender. Unfortunately, however, the legal charge has not been able to escape the fiction that lies at the heart of the mortgage.

4.2 THE LEGAL CHARGE BY WAY OF MORTGAGE

The LPA 1925 contemplated only two methods of creating a legal mortgage: the mortgage by sub-demise, and the legal charge by way of mortgage. Section 85(1) and (2) provides as follows.[18]

Law of Property Act 1925, s 85(1) and (2)

Mode of mortgaging freeholds

1. A mortgage of an estate in fee simple shall only be capable of being effected at law either by a demise for a term of years absolute, subject to a provision for cesser on redemption, or by a charge by deed expressed to be by way of legal mortgage.

Provided that a first mortgagee shall have the same right to the possession of documents as if his security included the fee simple.

[18] Law of Property Act 1925, s 86, contains similar provisions governing the mode of mortgaging leaseholds.

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2. Any purported conveyance of an estate in fee simple by way of mortgage made after the commencement of this Act shall (to the extent of the estate of the mortgagor) operate as a demise of the land to the mortgagee for a term of years absolute, without impeachment for waste, but subject to cesser on redemption, in manner following, namely:—

(a) A first or only mortgagee shall take a term of three thousand years from the date of the mortgage;

(b) A second or subsequent mortgagee shall take a term (commencing from the date of the mortgage) one day longer than the term vested in the first or other mortgagee whose security ranks immediately before that of such second or subsequent mortgagee;

and, in this subsection, any such purported conveyance as aforesaid includes an absolute conveyance with a deed of defeasance and any other assurance which, but for this subsection, would operate in effect to vest the fee simple in a mortgagee subject to redemption.

The mortgage by sub-demise creates a proprietary estate in the lender, although, rather than a fee simple, it is a leasehold estate for 3,000 years. The mortgage by sub-demise has, however, fallen into disuse as the legal charge by way of mortgage has gained in popularity.

The Land Registration Act 2002 (LRA 2002) reflects this trend by effectively rendering obsolete the mortgage by sub-demise. A legal mortgage of unregistered land will trigger first registration[19] and, whatever the form of mortgage, s 51 provides that it will have effect as a charge by deed by way of mortgage.

Land Registration Act 2002, s 51

Effect of completion by registration

On completion of the relevant registration requirements, a charge created by means of a registrable disposition of a registered estate has effect, if it would not otherwise do so, as a charge by deed by way of legal mortgage

Section 23 then provides that a registered owner is only capable of entering into a mortgage of a registered estate by way of charge.

Land Registration Act 2002, s 23

Owner's powers

1. Owner's powers in relation to a registered estate consist of—

(a) power to make a disposition of any kind permitted by the general law in relation to an interest of that description, other than a mortgage by demise or sub-demise, and

(b) power to charge the estate at law with the payment of money.

[19] Land Registration Act 2002, s 4(1)g.

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Thus it is the legal charge by way of mortgage that provides the pre-eminent form of legal mortgage and on which we will focus. But the effect of the mortgage by sub-demise has not been laid to rest, because s 87(1) of the LPA 1925 provides as follows.

Law of Property Act 1925, s 87(1)

Charges by way of legal mortgage

1. Where a legal mortgage of land is created by a charge by deed expressed to be by way of legal mortgage, the mortgagee shall have the same protection, powers and remedies (including the right to take proceedings to obtain possession from the occupiers and the persons in receipt of rents and profits, or any of them) as if—

(a) where the mortgage is a mortgage of an estate in fee simple, a mortgage term for three thousand years without impeachment of waste had been thereby created in favour of the mortgagee; and

(b) where the mortgage is a mortgage of a term of years absolute, a sub-term less by one day than the term vested in the mortgagor had been thereby created in favour of the mortgagee.

The result is a hybrid security interest: the lender gains a legal charge (not a lease),[20] but enjoys the same protections, powers, and remedies as if it held a lease for a term of 3,000 years. Certainly, there is no transfer to the lender of the borrower's freehold or lease: the borrower retains that estate, but holds it subject to the lender's legal charge.[21]

So the old fiction continues in a different, but just as complicated, form. The inappropriateness of this form has been highlighted by the Law Commission, which has long advocated reform by the adoption of a statutory form of security interest with defined rights and powers.

Law Commission Report No 204, *Land Mortgages* (1991, [2.14], [2.17]–[2.18], [3.1]–[3.2])

Removal of the distinction between mortgage and charge

A mortgage is conceptually different from a charge [. . .] However in English law the distinction is blurred and the terms are often used interchangeably, sometimes as if they were synonymous and sometimes as if one was a generic term including the other. The confusion is exacerbated by uncertainty over the correct classification of the mortgage by demise and the charge by way of legal mortgage. The mortgage by demise is technically a mortgage, in that it involves the grant of a substantial legal estate to the mortgagee. However, equitable restriction of the mortgagee's ownership-type rights has resulted in it acquiring a close

[20] *Grand Junction Co Ltd v Bates* [1954] 2 QB 160, 166; *Weg Motors Ltd v Hales* [1962] Ch 49, 74; *Cumberland Court (Brighton) Ltd v Taylor* [1964] Ch 29, 36; *Regent Oil Co Ltd v JA Gregory (Hatch End) Ltd* [1966] Ch 402.

[21] The section fails to articulate the position of the borrower—a position that has been criticized in the equivalent provision in the Australian State of Victoria: see *Figgins Holdings Pty Ltd v SEAA Enterpises Ltd* (1999) 196 CLR 245, [65], *per* McHugh J.

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resemblance to a charge. The charge by way of legal mortgage is in name and form a charge, but in substance it is the same as the mortgage by demise.

[...]

Inappropriateness of form

The second root cause of the artificiality and complexity of mortgage law is the methods used to create security interest in land give rise to inappropriate relationships between the parties. This is particularly apparent in the mortgage by demise [...]

The problem here is of central importance because it affects not only the mortgage by demise, but also the charge by way of legal mortgage which is treated by statute as if it were a mortgage by demise and the equitable mortgage of a legal estate which is treated in equity as if it were a legal mortgage, hence a mortgage by demise. The problem is that it creates a relationship of landlord and tenant between the parties. There is nothing unusual about using the leasehold relationship as an investment device: institutional lenders are probably more likely to use leases rather than mortgages as a means of financing property developments or investing in non-residential land. However, in the case of the mortgage by demise the leasehold relationship is the wrong way round: as tenant, the mortgagee has an inherent right to possession which would more appropriately lie with the mortgagor (subject to whatever restrictions may be necessary to protect and enforce the security). Similarly, it is necessary for the preservation of the security that the mortgagor should be under a duty more usually imposed by a landlord on a tenant, rather than a tenant on a landlord. Even if reversed, the landlord-tenant relationship is fundamentally different from that created by a mortgage: investors under a leased-based arrangement buy outright a share in the property, and the value of the share fluctuates in direct proportion to the value of the retained property; mortgagee-investors, on the other hand, have an interest in the property only for the temporary purpose of safeguarding the repayment of a loan or the value of the obligation secured. Historically the mortgage by demise was a useful device to bridge the gap between abolition of the mortgage by assignment and the general acceptance of the legal charge. Now that it has fulfilled that purpose, it seems an unnecessary impoverishment of the system to blur the distinction between the lease and mortgage by continuing to define one device in terms of the other.

[...]

Nature of the new mortgage

It is central to our proposal for the creation of a new kind of mortgage that the attributes of the mortgage should be expressly defined by statute, rather than defined by reference to pre-existing forms of mortgage or by analogy to any other legal relationship. It is therefore necessary to consider what interest in the mortgaged property a mortgagee ought to have under the new mortgage, whether formal or informal [...]

The guiding principle we have adopted in defining the nature of the new mortgage is that the only function of the mortgaged property is to provide security for the performance of the mortgagor's payment obligations. It follows from this that the nature and extent of the mortgagee's interest ought to be dictated by the need to preserve the value of the security and, where necessary, to enforce it.

4.3 EQUITABLE MORTGAGES AND EQUITABLE CHARGES OF LAND

The legal charge by way of mortgage now monopolizes the creation of legal security over land. In equity, there remains a number of ways in which an equitable security right can

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arise. To see the differences between legal and equitable security rights, we again need to focus on the *content* and *acquisition* questions (see Chapter 1, section 3).

4.3.1 Equitable charge of a legal estate: the *acquisition* question

A borrower with a legal estate in land may attempt to give a lender a legal charge by way of security—but to acquire such a legal interest, the lender needs to show that the borrower granted that right by means of a deed, and also that the lender has now registered its charge.[22] If those steps have not been taken, the lender may nonetheless acquire an *equitable* charge (under the doctrine of anticipation—see Chapter 9) by showing that the borrower is under a duty to grant the lender a legal charge. So, the lender will acquire an equitable charge if the borrower has made a contractual promise to grant a legal charge.[23] In addition, even if the borrower has made no contractual promise, a court can impose a duty to grant a charge if, in return for the loan provided by the lender, the borrower has attempted to grant a legal charge, but has failed to do so (e.g. because of a failure to comply with formality rules). In such cases, there can be said to have been an 'equitable charge' of the borrower's legal estate in the land.

Under this form of equitable security of a legal estate, the parties' relationship is treated in equity as if the agreement had been performed and a legal charge had been created. Thus, the lender is treated as if it had a legal charge by way of mortgage, with the benefit of the remedies and powers of a mortgage by sub-demise so far as they are consistent with the equitable nature of the lender's rights.[24]

To constitute this type of equitable charge of a legal estate, an agreement to create a legal mortgage must be valid. It should thus comply with the terms of s 2(1) of the Law of Property (Miscellaneous Provisions) Act 1989 (LP(MP)A 1989) (see Chapter 7, section 3). Prior to this enactment, it was common practice for lenders to take a deposit of the borrower's title deeds. This deposit of the deeds would create an equitable security: the loan supported by the act of deposit was interpreted both as evidence of the parties' agreement to create a legal charge, and as an act of part-performance to support the enforcement of that agreement. It is now clear that, given the formalities required under the LP(MP)A 1989, the practice of creating an equitable security by deposit is no longer possible.

United Bank of Kuwait plc v Sahib
[1997] Ch 107, CA

Peter Gibson LJ

At 137

I would emphasise the essential contractual foundation of the rule as demonstrated in the authorities. The deposit by way of security is treated both as prima facie evidence of a contract to mortgage, and as part performance of that contract. It is sufficient to refer briefly to

[22] See Chapter 7 for the general formality rules applying to the creation of a legal interest in land.

[23] It seems that the lender should also acquire an equitable charge if the borrower is under a *non-contractual* duty to grant a legal charge: see Chapter 10, section 2.2. For example, in *Kinane v Mackie-Conteh* [2005] EWCA Civ 45, the Court of Appeal found that proprietary estoppel imposed a duty on the borrower to grant a legal charge. As a result, the lender acquired an equitable interest in the land—although the Court held that the lender's interest arose under a constructive trust, not by means of an equitable charge.

[24] For example, an equitable chargee or mortgagee cannot sell the legal estate: Law of Property Act 1925, s 88(6) but see *Swift 1st Ltd v Colin* [2011] EWHC 2410.

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the more recent of the multitude of authorities. In *Re Wallis & Simmonds (Builders) Ltd* [1974] 1 All ER 561, [1974] 1 WLR 391 Templeman J held that the equitable charge resulting from a deposit of title deeds was contractual in nature and specifically rejected an argument that the charge arose by operation of law. In *Re Alton Corp* [1985] BCLC 27 at 33 Megarry V-C said, in relation to a loan accompanied by the deposit of title deeds:

> '[. . .] I have to remember that the basis of an equitable mortgage is the making of an agreement to create a mortgage, with the deposit of the land certificate and, since *Steadman v Steadman* [1974] 2 All ER 977, [1976] AC 536, probably the paying of the money as well, ranking as sufficient acts of part performance to support even the purely oral transaction. But some contract there must be.'

I accept that there need not be an express contract between the depositor of the title deeds and the person with whom they are deposited for an equitable mortgage to arise (subject to s 2). But I have already stated why it is clear from the authorities that the deposit is treated as rebuttable evidence of a contract to mortgage. Oral evidence is admissible to establish whether or not a deposit was intended to create a mortgage security [. . .],To allow inquiries of this sort after the 1989 Act in order to determine whether an equitable mortgage has been created and on what terms seems to me to be wholly inconsistent with the philosophy of s 2, requiring as it does that the contract be made by a single document containing all the terms of the agreement if it is to be valid [. . .]

To the extent that part performance is an essential part of the rationale of the creation of an equitable mortgage by the deposit of title deeds, that too is inconsistent with the new philosophy of the 1989 Act. As the Law Commission said in its report (para 4.13):

> 'Inherent in the recommendation that contracts should be made in writing is the consequence that part performance would no longer have a role to play in contracts concerning land.'

In the present case, for the reasons already given, it seems to me clear that the deposit of title deeds takes effect as a contract to mortgage and as such falls within s 2.

The judge said [at first instance] [1995] 2 All ER 973 at 990, [1995] 2 WLR 94 at 111:

> 'The recommendation [of the Law Commission] that contracts relating to land should be incorporated in a signed document which contains all the terms was, clearly, intended to promote certainty. There is no reason why certainty should be any less desirable in relation to arrangements for security over land than in relation to any other arrangements in respect of land. The present case itself illustrates the need to be able to identify the obligation which is to be secured. I do not find it surprising that Parliament decided to enact legislation which would be likely to have the effect of avoiding disputes on oral evidence as to the obligation which the parties intended to secure.'

I agree. Indeed, it seems to me that the whole of the judge's reasoning, to which I would pay tribute, on the s 2 point cannot be faulted. Like him, I am fortified by the support for the same conclusion given in *Emmet on Title* para 25.116. I therefore conclude that by reason of s 2, the mere deposit of title deeds by way of security cannot any longer create a mortgage or charge.

In Chapter 11 we examined how arrangements that fail to comply with s 2(1) may nevertheless continue to have effect through the doctrines of proprietary estoppel or constructive trusts. In *Sahib*, Peter Gibson LJ rejected the lender's arguments that it had acquired an equitable charge on the grounds of proprietary estoppel or a constructive trust—but in *Kinane v Mackie- Conteh*,[25] in which the lender advanced £50,000 in reliance upon the

[25] [2005] EWCA Civ 45, noted Dixon [2005] Conv 247 and McFarlane [2005] Conv 501.

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parties' understanding that the loan would be secured, a similar argument succeeded and the lender did acquire an equitable charge.[26]

It does seem correct that the lender should acquire an equitable charge if the borrower is under a *non-contractual* duty to grant a legal charge, however, in light of the House of Lords' decisions in *Cobbe v Yeoman's Row Management Ltd*[27] and *Thorner v Major*[28] the role of proprietary estoppel in the creation of equitable interests (particularly in the commercial context) must now be re-examined.

4.3.2 Equitable mortgage of an equitable estate: the *content* question

If the borrower has no legal estate in land, but only an equitable interest, then it is impossible for the lender to acquire a legal charge: the content of the borrower's property right prevents it. In such a case, any security interest acquired by the lender must take an equitable form. Such a right can arise by means of an equitable mortgage: if, for example, the borrower transfers his or her equitable interest to the lender. Such equitable mortgages are not as common as mortgages of the legal estate, but they may arise where a purchaser mortgages his or her equitable interest under a sale and purchase agreement of land, or where a beneficiary under a trust of land has mortgaged his or her interest. Where an equitable mortgage is created intentionally, it is created in the classic form by assigning the borrower's equitable interest to the lender, subject to the lender's covenant to reassign upon repayment of the loan. But an equitable mortgage of an equitable interest may arise unintentionally: for example, consider a case in which a freehold or lease is held jointly by two co-owners under a trust of land.[29] One of the co-owners then purports to mortgage the legal estate by forging the other co-owner's signature. The purported legal charge by way of mortgage cannot be valid—but the lender will acquire an equitable security right, taking effect only against the equitable share of the co-owner who purported to grant the legal charge.[30] A similar result can apply where the other co-owner does consent to the legal charge, but does so as a result of undue influence or misrepresentation (see Chapter 29, section 3.1).

4.3.3 Equitable charge: the *content* question

Finally a charge may be created in equity, whether over a legal estate or an equitable interest in the land, where the parties demonstrate an intention that the lender's right is to make available, or appropriated, for the discharge of a debt or other obligation. That intention must be evinced in writing, but no particular form of words is required.[31] In such a case, the lender acquires an equitable property right due to the content of the borrower's duty to the lender: a duty to allow the lender to use the borrower's right to meet the debt, should the borrower fail to repay. This form of security right is *not* special to land: as we saw in section 3.4 above, it arises whenever a borrower comes under such a duty to a lender.

[26] Although it has been suggested that estoppel is an inadequate replacement for part-performance: see Griffiths [2002] Conv 216.

[27] [2008] UKHL 55, [2008] 1 WLR 1752.

[28] [2009] UKHL 18, [2009] 1 WLR 776.

[29] See Chapters 16 and 17.

[30] See *Ahmed v Kendrick* [1988] 2 FLR 22; *First National Securities Ltd v Hegerty* [1985] QB 850; *Thames Guaranty Ltd v Campbell* [1985] QB 210.

[31] See Law of Property Act 1925, s 53(1)a.

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It must be remembered that this form of equitable charge is conceptually different from the equitable charge that we examined in section 4.3.1 above, when looking at equitable charge of the legal estate. Where there is such an equitable charge, the borrower is under a duty to grant the lender a legal interest: a legal charge. The lender can thus call for that right, and, with it, will acquire all of the powers and remedies associated with a legal charge. In the case of the equitable charge examined in this section, however, the lender enjoys none of these rights. Its implied rights are confined to a right to apply to court for an order for sale or the appointment of a receiver.

In the following extract, McFarlane emphasizes this distinction by giving different names to the form of equitable charge that we examined in section 4.3.1 above and that which we have examined in this section. In the passage, a legal charge by way of mortgage is referred to as a 'charge'. The first type of equitable charge is then called an 'equitable charge' and the second a 'purely equitable charge'. This underlines the fact that, in the second case, the borrower is under no duty to give the lender a legal interest in land.

McFarlane, *The Structure of Property Law* (2008, p 818)

It is important to distinguish between (i) an Equitable Charge; and (ii) a Purely Equitable Charge. First, an Equitable Charge, unlike a Purely Equitable Charge, can exist only in relation to land. Second, even where land is concerned, there is a difference between the two rights. An Equitable Charge arises where [the borrower] is under a duty to grant [the lender] a Charge. A Purely Equitable Charge arises where [the borrower] is under a duty to hold his Freehold or Lease as security for a duty owed to [the lender]. Third, formality rules can apply differently to each right:

Equitable Charge: Where [the borrower] has a Freehold or Lease, his power to come under a *contractual* duty to give [the lender] a Charge is regulated by s.2 of the 1989 Act [. . .] However, [the lender] can acquire an Equitable Charge in the absence of writing if [the borrower] is under a *non-contractual* duty to give [the lender] a Charge.

Purely Equitable Charge: Where [the borrower] has a Freehold or Lease, his power to make a contractual promise to hold his right as security is regulated by s.53(1)(a) of the LPA 1925. That rule requires only writing signed by A.

4.3.4 Equitable security rights in land: reform?

We have distinguished between three different ways in which a lender can acquire an equitable security interest in land. The Law Commission recommended the rationalization of this confusing multiplicity of forms.

Law Commission Report No 204, *Land Mortgages* (1991, [2.13])

Reduction in the number of types of security

Whilst this proliferation of types of security interest in land is historically explicable, we are satisfied that it no longer serves any useful purpose. As far as legal mortgages are concerned, it is difficult to justify the continued existence of the mortgage by demise, given that it is no longer used in practice and has the same effect in law as the charge by way of legal mortgage [the mortgage by sub demise is effectively obsolete—see 4.2 above]. The

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problem of equitable security in a legal estate is rather different. The principle underlying equitable mortgages of the legal estate is the rule in *Walsh v Lonsdale*, a general property law principle which applies to mortgages in precisely the same way as it applies to fee simples, leases and easements. Nevertheless, if the equitable charge is included it does mean that there are at least three, and possibly four, ways of taking informal security over the legal estate. Whilst there are small differences in the effect between these different types of equitable security, there is no apparent difference in function: none seems to fulfill a function that could not be fulfilled by any one of the others. The same can be said of the different ways of taking security over equitable interests in land: responses to the Working Paper confirmed that the differences in form and effect between equitable mortgages and equitable charges are regarded as no practical significance. Finally, there is the question of whether it remains necessary for the method of creating a security interest over an equitable interest to be different from the method for creating a security interest over a legal estate. In the Working Group we put forward the view that there was no reason in principle why the same type of security should not be used for both legal and equitable interests in land [. . .]

4.4 CHARGING ORDERS

A charging order provides a means by which a judgment creditor can enforce his or her judgment, by providing some of the advantages conferred by security. Charging orders are governed by the Charging Orders Act 1979. In theory, a judgment creditor can apply for a charging order over *any* property of the debtor; in practice, however, a judgment creditor is likely to ask for a charging order in relation to valuable, immovable property—the debtor's land.

Charging Orders Act 1979, s 1(1)

Charging orders

(1) Where, under a judgment or order of the High Court or a county court, a person (the "debtor") is required to pay a sum of money to another person (the "creditor") then, for the purpose of enforcing that judgment or order, the appropriate court may make an order in accordance with the provisions of this Act imposing on any such property of the debtor as may be specified in the order a charge for securing the payment of any money due or to become due under the judgment or order.

The judgment creditor must thus apply to court for the grant of a charging order.[32] If a charging order is granted, a charge is created over the judgment debtor's interest in land as specified in the order to secure the payment of the judgment debt,[33] and should accordingly be registered to preserve its priority.[34] This charge has '*the like effect and shall be*

[32] The making of the order is a two-stage process. Initially, the charging order nisi is granted usually ex parte. If the judgment debtor fails to meet the judgment as required by the order nisi, the charging order is made absolute.

[33] Including a beneficial interest held under a trust of land: see Charging Orders Act 1979, s 2(1)(a)(i).

[34] In respect of a registered estate by a notice, see Land Registration Act 2002, ss 32–4, or by a restriction where the judgment debtor's interest is a beneficial interest under a trust, see Land Registration Act 2002, s 42(1)(c) and (4). Where land is unregistered, a charging order against the judgment debtor's legal title is

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enforceable [. . .] in the same manner as an equitable charge created by the debtor under his hand'.[35] The judgment creditor becomes a secured creditor and will be able to claim priority against unsecured creditors if the debtor becomes insolvent. The charging order may be enforced by application to court for an order for sale, or for the appointment of a receiver.

A judgment creditor thus must submit to the court's discretion at two points: firstly, when the court decides whether or not to make the order; and secondly, when the court decides whether or not the charging order should be enforced.

The court in exercising its initial discretion whether or not to grant a charging order must consider all of the circumstances of the case, including the personal circumstances of the debtor and whether any other creditor would be prejudiced by the order.[36] Where relevant circumstances subsequently come to light, the court may vary or discharge the charging order.[37]

Charging Orders Act 1979, s 1(5)

Charging orders

(5) In deciding whether to make a charging order the court shall consider all the circumstances of the case and, in particular, any evidence before it as to—

(a) the personal circumstances of the debtor, and

(b) whether any other creditor of the debtor would be likely to be unduly prejudiced by the making of the order.

A creditor, although not entitled to a charging order, can expect an order to be granted in its favour unless there are circumstances that would persuade a court that an order should not be made. For example, a charging order will not be granted if it is likely that the debtor will become bankrupt or go into liquidation; in such a case, a charging order would give the judgment debtor an undue advantage over other unsecured creditors.[38]

Where the judgment debtor's interest is an interest in his or her home, which he or she holds jointly with his or her spouse or partner, the court will also consider the position of that spouse or partner and any children. The situation may be complicated by the possibility that divorce proceedings are contemplated, or pending, in which the judgment debtor's spouse is entitled to claim ancillary relief. In these circumstances, there is a balance to be struck between the exercise of the court's family jurisdiction, in which the welfare of any

registrable as an order affecting land: see Land Charges Act 1972, s 6(1)(a); but where the judgment debtor holds a beneficial interest under a trust of unregistered land, there is no provision for registration.

35 Charging Orders Act 1979, s 3(4).

36 The charging order process has been criticized as deficient to draw out the relevant circumstances, see Capper, Conway and Glennon, 'From Obligation to Proprietary Interest: A Critique of the Charging Order System in England and Wales' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011), ch 4.

37 The application can be made by the debtor or any other person with an interest in the property: see s 3(5).

38 *Roberts Petroleum Ltd v Bernard Kenny Ltd* [1983] 2 AC 192; *Nationwide Building Society v Wright* [2009] EWCA Civ 811, [2010] Ch 318.

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children are a primary consideration, and the court's commercial jurisdiction, in which contracts must be honoured and judgment debts paid.

The Court of Appeal, when considering this balancing exercise, has made clear that its approach will depend upon the timing of the creditor's and wife's applications.

Harman v Glencross
[1986] Fam 81, CA

Balcombe LJ

At 98

[. . .] I think it right to set out how I conceive the court should deal with a similar problem when next it occurs.

1. Where a judgment creditor has obtained a charging order nisi on the husband's share in the matrimonial home and his application to have that order made absolute is heard before the wife has started divorce proceedings, there is, of course, no other court to which the application for the charging order absolute can be transferred, the wife having no competing claim to the husband's share. In those circumstances it is difficult to see why the court should refuse to make the charging order absolute, and the wife's right of occupation should be adequately protected under [now s 14 of the Trusts of Land and Appointment of Trustees 1996].
2. Where the charging order nisi has been made after the wife's petition, then on the application for a charging order absolute the court should consider whether the circumstances are such that it is proper to make the charging order absolute, even before the wife's application for ancillary relief has been heard by the Family Division. There will, of course, be cases (such as *Llewellin v. Llewellin* (unreported), 30 October 1985, Court of Appeal (Civil Division) Transcript No. 640 of 1985, which we heard immediately after this appeal) where the figures are such that even if the charging order is made absolute, and then the charge is realised by a sale of the house, the resultant proceeds of sale (including any balance of the husband's share after the judgment debt has been paid) will be clearly sufficient to provide adequate alternative accommodation for the wife and children.
3. Unless it appears to the court hearing the application for the charging order absolute that the circumstances are so clear that it is proper to make the order there and then, the usual practice should be to transfer the application to the Family Division so that it may come on with the wife's application for ancillary relief, and one court can then be in a position to consider all the circumstances of the case. When considering the circumstances, the approach of the court should be to recall the statement of Sir Denys Buckley in the *Hegerty case* [1985] Q.B. 850, 866, that a judgment creditor is justified in expecting that a charging order over the husband's beneficial interest in the matrimonial home will be made in his favour. The court should first consider whether the value of the equity in the house is sufficient to enable the charging order to be made absolute and realised at once, as in *Llewellin v. Llewellin* (unreported), even though that may result in the wife and children being housed at a lower standard than they might reasonably have expected had only the husband's interests been taken into account against them. Failing that, the court should make only such order as may be necessary to protect the wife's right to occupy (with the children where appropriate) the matrimonial home. The normal

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course should then be to postpone the sale of the house for such period only as may be requisite to protect the right of occupation—a Mesher type of order—again bearing in mind that the court is holding the balance, not between the wife and the husband, but between the wife and the judgment creditor. If the judgment creditor asks, even in the alternative to his claim to an immediate order, for a Mesher type of order, then it seems to me that it would require exceptional circumstances before the court should make an order for the outright transfer of the husband's share in the house to the wife, thereby leaving nothing on which the judgment creditor's charging order can bite, even in the future. Finally, the court should consider whether there is any point in denying the judgment creditor his charging order, if the wife's rights of occupation could in any event be defeated by the judgment creditor making the husband bankrupt.

4. Once the charging order absolute has been made, it would normally require some special circumstances—e.g., where (as here) the wife had no proper opportunity to put her case before the court—for the court to set the charging order aside under section 3(5) of the Charging Orders Act 1979, and thereby deprive the judgment creditor of his vested right.

A creditor holding the benefit of a charging order cannot sell the charged property out of court. They must once again apply to the court to enforce the charging order by applying for an order for sale. Where the debtor's interest is an interest under a trust of land held in co-ownership with others, the creditor will need to apply for an order for sale under s 14 of the Trusts of Land and Appointment of Trustees Act 1996, when the court will be guided by the criteria found in s 15 when deciding whether or not to order sale. This jurisdiction has already been considered in Chapter 18. In *Close Invoice Finance Ltd v Pile*[39] the court indicated that similar considerations will also influence their discretion to order sale where the debtor is the sole owner of the charged property.

There has been an alarming increase in the use of charging orders in recent years as unsecured creditors have become more aggressive in the recovery of their debts.[40] This increase has triggered proposals to curb their use in the recovery of smaller consumer debts.[41]

5 EQUITY OF REDEMPTION

We have seen that, under a classic mortgage by conveyance or sub-demise, the borrower holds the equity of redemption—an equitable property right that represents the value of the land less the amount owed to the lender under the mortgage. We now need to examine this influential concept and, in particular, its continuing place (if any) in the modern law, given that the classic mortgage has essentially been replaced by the device of the legal charge by way of mortgage.

[39] [2008] EWHC 1580, [2009] 1 FLR 873.

[40] See Capper, Conway and Glennon, 'From Obligation to Proprietary Interest: A Critique of the Charging Order System in England and Wales' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011), ch 4.

[41] Ministry of Justice, Orders for Sale Consultation CP2/10 (February 2010).

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5.1 DEVELOPMENT OF THE EQUITY OF REDEMPTION

The exact time at which the equity of redemption was first recognized is difficult to trace, but what is clear is that it emerged as an equitable response of the Chancery courts to the harsh terms of the common law mortgage by conveyance. The form of the mortgage by conveyance transferred the borrower's entire estate in the land to the lender, subject only to a covenant by the lender to reconvey the land to the borrower upon the borrower repaying the loan at the time and in the manner agreed. The agreement of the parties thus gave the borrower a contractual or legal right to redeem. If the borrower failed to repay as required, the lender was not obliged to perform the covenant to reconvey. The lender was instead entitled to retain the land as its legal owner, free from the covenant, and so the borrower lost (or forfeited) his or her land, even though it might be worth considerably more than the mortgage debt.

The common law rule was clear, but harsh, and from the seventeenth century, courts of equity were routinely coming to the aid of the borrower by allowing repayment after the legal date for redemption had passed and thus allowing the borrower to recover his or her land.[42] The means by which equity upheld the borrower's equitable right to redeem is not entirely clear. The possibilities, as Watt explains, were an award of specific performance of the lender's covenant to reconvey, or the grant of relief to the borrower against forfeiture.

Watt, 'Mortgage Law as Legal Fiction' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007, p 81)

> The next challenge is to identify the doctrines by which it was developed, for this will determine whether it is realistic to remove the fiction. There are two main candidates for the doctrinal source of equity's refusal to follow the law in the mortgage context. On the one hand, there is the equity's doctrinal commitment to relieve against penalties and closely related to it, the equitable doctrine of relief from forfeiture. On the other hand, there is equity's willingness to issue injunctions (decrees) requiring specific performance of the mortgagee's covenant to reconvey the mortgage land to the mortgagor. The two bases are compatible but distinct. The former is concerned to set aside the conveyance to the mortgagee, whereas the latter is concerned to enforce the reconveyance to the mortgagor. Both bases were united in permitting the mortgagor to bring a bill to redeem even though it was considered at law to breach the mortgagor's covenant to grant the mortgagee quiet enjoyment of the estate conveyed.

This right became known as the 'equitable right to redeem', which would only be lost if the Chancery courts could be persuaded that there was little or no hope of the borrower being able to repay. In such a case, the lender would be granted a decree of foreclosure. The equitable right to redeem came to be recognized as no mere personal right, but a proprietary right, which could itself be sold or mortgaged, representing, as it did, the borrower's equitable 'ownership' of the land.[43] What is more, to retain the essential security nature of the classic

[42] See *Emmanuel College v Evans* (1625) 1 Ch Rep 18. There is some earlier evidence, from the reign of Elizabeth I onwards, that Chancery would assist a borrower in certain circumstances, but it seems that assistance became routine from the early seventeenth century.

[43] *Casborne v Scarfe* (1738) 1 Atk 603, 26 ER 377.

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mortgage by conveyance, courts of equity were at pains to protect the borrower's equity of redemption. This aim was accomplished by the principle that there should be no 'clogs and fetters' on the equity of redemption. We will examine the continued significance of this principle in the next chapter.

In the face of the borrower's equitable right to redeem, the legal date for redemption lost its import. It is now regarded as a merely nominal date and is often set to occur shortly after the mortgage is entered into. It is the equitable right to redeem upon which borrowers rely to insist upon their right to repay their mortgage and to clear their property of its mortgaged status.

The evolution of the equity of redemption provides an interesting insight into the emergence of equitable doctrine, and the relationship between the courts of common law and equity. It emerged at a time when a number of influential Lord Chancellors were shaping the Chancery jurisdiction from an ad hoc jurisdiction based upon individual petitions, to a coherent body of fundamental rules and principles.[44] Inevitably, at times, this set Chancery at odds with the position at common law. This was certainly the case with the development of the equity of redemption: it amounted to a '*barefaced disavowal of the legal form*'[45] of the mortgage by conveyance. But then the mortgage by conveyance was, itself, a mere form developed originally to overcome restrictions on charging interest imposed by the laws against usury. Thus it may well have been that the courts of common law were not wholly opposed to these developments, achieving as they did a degree of fairness to protect the vulnerable borrower. The emergence of the equity of redemption may also have been accommodated by judges, drawn largely from the nobility, to the threat presented by lenders to the forfeiture of their fellow noble landowners' estates.[46]

5.2 EQUITY OF REDEMPTION AND THE LEGAL CHARGE

The equity of redemption is a key component of the classic form of mortgage by conveyance. It thus retains its import in the equitable mortgage by conveyance (see section 4.3.2 above)—but what of the predominant form of legal mortgage: the legal charge?

Under a legal charge, the borrower retains his or her freehold or lease, but his or her land is encumbered (or burdened) by the legal charge.[47] We have already seen that, as a result of s 87(1) of the LPA 1925, the lender enjoys the rights powers and remedies of a mortgagee by sub-demise, although the section does not actually confer a lease upon the lender. The lender's interest in the borrower's land is merely that of a legal charge. The problem is that the section does not clarify the borrower's position.

McHugh J made this observation, giving judgment in the following case (referring to the Torrens system registered charge under the Australian State of Victoria's equivalent legislation).

[44] Including, in particular, Lords Bacon, Nottingham, and Hardwick.

[45] Watt, 'Mortgage Law as Legal Fiction' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007) p 80.

[46] Sugarman and Warrington, 'Telling Stories: Rights and Wrongs of the Equity of Redemption' in *Property Problems: From Genes to Pension Funds* (ed Harris, 1997), p 207.

[47] But see *Horsham Properties Group Ltd v Clark* [2008] EWHC 2327, [22], in which Briggs J said '*whilst it is true that the mortgagor of registered land remains the registered proprietor* [. . .], *it is wrong in substance to describe the rights of such a mortgagor as tantamount to freehold ownership*'.

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Figgins Holdings Pty Ltd v SEAA Enterprises Ltd
(1999) 196 CLR 245, High Court of Australia

McHugh J

At [65]

The great difficulty of the cases arises from the attempt by s81 [Transfer of Land Act 1958 (Vic)] to confer on the mortgagee the rights and remedies of a mortgage at common law when the nature of the Torrens system mortgage is fundamentally different from that of the common law mortgage. The difficulty is increased by the section's failure to define the liabilities of, and the consequences for, the mortgagor as a result of conferring these common law rights and remedies on the mortgagee.

Thus, for example, under a mortgage by conveyance or sub-demise, the lender has an immediate right to possession arising by virtue of the legal estate that is preserved by s 87(1). Under a classical mortgage by conveyance or sub-demise, the borrower's right to possession was cast as that of a mere tenant at will, occupying by the permission of the lender, but under a legal charge, the borrower retains the legal estate and thus equally has a right to possession by reason of that estate, subject only to the lender's ability to assert its own right to possession should it wish to do so.[48]

Likewise, whilst, under a classic mortgage by conveyance, the borrower needed to recover or redeem legal title to the land when the debt was repaid, under a legal charge, there is nothing to recover. There is a charge to remove, but the act of repayment extinguishes the charge. Once there is no debt, there can be no effective appropriation of property to its repayment to constitute the charge. The formality rules governing land do call for documentary evidence of the discharge of a legal charge, either through a deed or a written receipt,[49] which, in the case of a registered charge, will also have to be recorded at the Land Registry. These documents also provide convenient evidence that the debt has been repaid.

Nield has questioned the utility of the equity of redemption as a distinct proprietary interest in cases in which the lender has a legal charge.

Nield, 'Charges, Possession and Human Rights: A Reappraisal of Section 87(1) Law of Property Act 1925' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005, p 159)

Redemption in the sense of obtaining a reconveyance or cesser of the mortgaged estate is inconsistent with a legal charge for there is simply no transfer of the borrower's estate or the creation of demise by way of security. The borrower retains the legal estate, so there is neither any property of the borrower to redeem or recover from the lender nor any proviso for redemption from which relief can be granted. What is necessary is a continuing right to require the lender to accept repayment of the debt and effect a discharge, despite default in the borrower's repayment obligations. Thus whilst it is appropriate to speak of an equitable

[48] *Figgins Holdings Pty Ltd v SEAA Enterprises Ltd* (1999) 196 CLR 245, High Court of Australia, at [82]–[83], [87]–[88].

[49] See Law of Property Act 1925, ss 52 and 115.

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right to repay, or of discharge, it is questionable whether it is still accurate to refer to the borrower's equity of redemption in the sense of a distinct proprietary interest.

If the borrower's continued right to repay the debt and obtain a discharge represents a separate equitable interest which does not merge with his legal estate, it is appropriate to speak of a distinct equity of redemption. However, if the continuing right of the borrower to obtain a discharge upon repayment, regardless of default, is characterised as an incident of the borrower's estate then the use of the term equity of redemption, as distinct from an equitable right of repayment, is strained. The borrower continues to hold the legal and beneficial ownership of the mortgaged land, subject only to the burden of the charge, thus it could be argued that there is no room or need for a separate proprietary interest in the form of an equity of redemption.

Watt goes further and suggests that it is time to kill off the equity of redemption.

Watt, 'Mortgage Law as Legal Fiction' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007, p 87)

Parliament has killed off the mortgage by conveyance and reconveyance of a fee simple, yet the courts have so far failed to acknowledge that the notion of the equity of redemption should have died with it. They have failed to acknowledge that land subject to a registered charge is not 'redeemed' as was land conveyed under the classic form of mortgage rather the charge is simply discharged from the land upon repayment of the debt.

Killing the equity of redemption would breathe reality into the position of the parties under a legal charge and cement the legal charge as a pure security interest. It would also provide the opportunity to remove, or at least recast, a number of doctrines that were associated with redemption. These are the doctrines of consolidation, the entitlement of the lender to costs on redemption, and the clogs and fetters doctrine. We will examine this latter doctrine and its continued utility in the next chapter.

Consolidation entitles a lender holding two or more mortgages over different pieces of land owned by the borrower to insist upon the redemption of all of these mortgages, should the borrower seek to repay any one of them. Consolidation thus gives the lender an equitable right, developed in response to the borrower's equitable right to redeem. If the borrower was seeking the indulgence of equity to redeem after the legal date for redemption, he or she was required to meet certain conditions: namely, to pay the costs of redemption, and to redeem all mortgages granted to the lender, if the lender so required. Consolidation is controversial and s 93 of the LPA 1925 excludes the right unless it is expressly preserved, which lenders usually insist it is. The Law Commission has recommended the abolition of consolidation.[50] The Australian courts have taken that step, by rejecting the lender's rights to redemption costs and to consolidate on the grounds that it is inconsistent with the concept of a charge.[51]

[50] Law Commission Report No 204 (1991), [6.44].
[51] *Greig v Watson* (1881) 7 VR 79; *Perry v Rolfe* [1848] VLR 297.

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6 MODERN DEVELOPMENTS IN MORTGAGE FORMS

Changing social and economic trends means that there is always pressure to develop alternative means of unlocking the security potential of land. The domestic lending market has seen the development of Islamic mortgages, the emergence of shared-ownership schemes to assist low-income borrowers—particularly first-time buyers—mount the first step of the home-ownership ladder, and equity release schemes to enable the elderly to use the investment value of their home to fund their living expenses. Further, the onward march of the European single market has seen proposals to developing a European form of mortgage, or *Eurohypothec*.

6.1 ISLAMIC MORTGAGES OR HOME PURCHASE PLANS

Islam prohibits the charging of interest (*riba*).[52] Making a profit from trade is permitted, but the charging of interest is unacceptable, because it reduces the risk that is inherent in trade. Traders share the risk that market movements (whether up or down) may adversely affect them, but the charging of interest cushions only the lender against the risk that the borrower is unable to repay the loan.[53] The charging of interest, which is an inherent part of conventional mortgage lending, thus presents a problem to followers of Islam, particularly those who wish to purchase their own home. A number of financial institutions have thus developed mortgage products that are thought to comply with Islamic principles.[54]

There are three main products available to assist with the purchase of a house, as follows:

- The *murabaha* utilizes the concept of deferred purchase. The bank purchases the property from the seller, but then agrees to sell on to the borrower at a price that reflects the original price plus an agreed profit. The purchase price is then paid by the borrower by periodic payments over a fixed period of time. Title is usually transferred to the borrower immediately, with the outstanding purchase price being secured by a mortgage.
- The *ijarah* is based upon a lease. The lender purchases the property that the borrower wishes to buy and then leases it to the borrower for a fixed period. The lease is coupled with an agreement by the lender to sell the property to the borrower at the end of the term.[55] The rent is periodically assessed to reflect the capital value of the property, prevailing market rentals, and a contribution to the final resale price (being the original sale price minus the deposit already paid). Thus, at the end of the term, the borrower will have paid the lender the full purchase costs plus a return to the lender, by making the rental payments.
- The diminishing *musharakah* involves shared ownership. Again, the lender purchases the property and leases it to the borrower—but part of the monthly payment made by the borrower goes toward increasing his or her ownership share in the property, so that the rental element of the periodic payment diminishes as the borrower's ownership share increases.

[52] *The Qur'an*, [30.39], [4.161], [3.130]–[3.132], and [2.275]–[2.281].
[53] See further Watt (2007), p 94.
[54] See Latif, 'Islamic Finance' (2006) 1 JIBFL 10.
[55] Technically, this is known as *ijarah wa iqtinah*.

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All of these methods utilize different vehicles, but, like a conventional mortgage, the borrower makes periodic payments to the lender to reflect repayment of the original capital cost, together with a financial return to the lender. There is continuing debate amongst Islamic scholars as to whether these schemes do, indeed, comply with Islamic principles, the payments being made by the borrower reflecting profit to the lender, rather than a genuine sharing of commercial risk. The diminishing *musharakah* is seen as the most in tune with sharia law.

6.2 LOW COST HOME OWNERSHIP

Property prices in many parts of the country are now so high that many cannot afford to buy a home, even with the aid of a mortgage, and the credit crunch has reduced the availability of mortgage finance. One response of the government has been to develop schemes to help those with insufficient income to fund a purchase from their own resources and mortgage from a private sector lender. A myriad of different schemes are clustered around two legal models. First, in shared ownership or 'part-buy, part-rent' schemes a buyer purchases a share in a property—usually from a housing association—using mortgage finance and pays rent on the unpurchased share. Here, therefore, the mortgage is combined with rent and the purchaser is granted a 'shared ownership lease'. Secondly, in shared equity schemes a government-backed loan, combined with a loan from a house builder, is used to provide top-up finance to enable the purchase of a home. The top-up loans are secured as second charges on the property. Typically, the purchaser will pay no interest on the second charges for an initial number of years and will pay a low rate of interest thereafter. However, the amount repayable to discharge the loans is not necessarily based on repayment of the capital sum plus interest as is the case with commercial finance. Instead, the purchaser repays the loan as a proportionate percentage of the value of the property. Hence, for example a 25 per cent shared equity loan is repaid at 25 per cent of the value of the property at the time the debt is discharged. Under both models, as the buyer's financial situation permits he or she can increase his or her share of ownership until he or she fully owns the property—a process known as 'staircasing'.

Assistance is also provided to local authority and housing association tenants to purchase their home at a discounted price, through a Right to Buy/Acquire,[56] Although the Right to Buy appeared to have run its course, the Government has recently announced plans to reinvigorate the scheme.[57]

6.3 EQUITY RELEASE OR HOME REVERSION PLANS

As homeowners get on in years, they may find that they own a valuable home (having paid off their mortgage), but that they have little income. They could, of course, move and buy a less valuable home, invest the balance, and live off that investment income. But if they do not want to move, they may consider using the value of their home through an 'equity release', or 'home reversion', plan, to provide either a lump sum or a regular income (or both). These plans can take a number of forms, but the key features are that the homeowner

[56] See Housing Act 2004, Pt 6.
[57] HM Government, *Laying the Foundations: A Housing Strategy for England* (2011).

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grants either a mortgage or a share of the ownership of his or her home to the lender, in return for regular periodic payments or a lump sum, which can be invested in an annuity or other investment vehicle to provide a regular income.

6.3.1 Lifetime mortgage

The idea of a lifetime mortgage is that it is not repayable until the borrower dies. Some schemes also provide that the lender will share in any increase in value of the home. There are various ways in which interest can be paid under these schemes. It may be paid on the usual interest-only basis, but, if the borrower is already short of income and cannot meet regular interest payments, the interest may be 'rolled up' and added to the capital secured by the mortgage. In that case, the interest is only repayable when the borrower dies or sells his or her home. Alternatively, an annuity may be purchased with the advance and part of the income from the annuity used to meet the interest due.

6.3.2 Home reversion plans

Under a home reversion plan, the borrower sells all of, or a share in, the house to a specialist company, which thus benefits from any further increase in the value of the home. Where the whole house is sold, it is leased back to the borrower—usually only for a nominal rent—for a term that may be brought to an end when the borrower dies. The sale price for the house is less than its market value with vacant possession, to reflect the fact that the borrower remains in occupation.

These plans have proved controversial. They are often quite complicated in their terms, with technicalities that it can be challenging for an elderly borrower to understand. They also play on the desire of the borrower to stay in his or her own home.

6.4 THE EUROHYPOTHEC

The idea of developing a common form of mortgage for Europe was first mooted by the European Commission over forty years ago.[58] This idea has moved a little nearer reality, with the European Commission Green Paper on *Mortgage Credit in the European Union*,[59] which reports that serious consideration is being given to '*the feasibility and desirability*' of a Euromortgage. In response, a European Union research group has put forward proposals for a European mortgage, or *Eurohypothec*.[60] Their proposal is not to replace the numerous security devices used in the member States, but to provide an alternative common form, to be governed by the laws of the country in which the land is situated, and which can operate alongside national forms. It will thus be vital that the national laws of the member States are able to accommodate the proposed Eurohypothec.

The form of proposed Eurohypothec is intended to be very flexible. The proposal is for a non-accessory form of charge, which, although it would secure repayment of a debt,

[58] European Commission, *The Development of a European Capital Market* (1966) [153]–[158].

[59] (2005) [48].

[60] See http://www.eurohypothec.com and Mortgage Credit Foundation, *Mortgage Bulletin 21: Basic Guidelines for a Eurohypothec* (2005); Nassarre-Aznar, 'The Eurohypothec: A Common Mortgage for Europe' (2005) 69 Conv 32; Watt, 'The Eurohypothec and the English Mortgage' (2006) 13(2) MJECL 173.

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may exist independently of that debt.[61] It is envisaged that the Eurohypothec would be registered in a public registry by an entry that would show (amongst other details) the amount of money secured. Even though the borrower can repay the loan and insist upon the Eurohypothec being discharged from the land, it will remain registered until the entry is removed with the consent of both the borrower and the lender. The benefit of a registered Eurohypothec can thus be transferred to another lender. The gap between the loan and the Eurohypothec would be bridged by a security agreement, governed also by the law of the member State in which the land is situated. The security agreement would form a contract between the lender and borrower, and would provide for such matters as the terms upon which the Eurohypothec is held and enforced. If the benefit of a Eurohypothec were to be transferred to another lender, there would need to be a new security agreement to govern the relationship between the borrower and the new lender. A failure to enter into a new security agreement would entitle the borrower to insist upon the discharge of the Eurohypothec.

All existing forms of security in England are accessory to a debt. Once the debt is repaid, the borrower can insist that the security interest over his or her land is extinguished. We will see in the next chapter that equity has carefully guarded the borrower's right of redemption; thus the notion that a security interest may continue to affect the borrower's land even though the debt has been repaid presents somewhat of a problem for English law.[62]

There are other points of tension between the proposed Eurohypothec and English law.[63] For example, it is proposed that the borrower may hold the benefit of a Eurohypothec over his or her own land, but English law has always refused to accept such a proposition, because of the corollary impossibility of owing a duty to oneself. Furthermore, the priority provided by the LRA 2002 for overriding interests does not accord with the priority that is envisaged for a registered Eurohypothec. Even if these doctrinal issues could be overcome, the most significant stumbling block, both for English law and for the law of other member States, is likely to be compatibility of enforcement of the Eurohypothec with existing consumer protection—particularly over domestic property.[64]

Whether or not these issues can be overcome across all of the member States will hinge upon whether the economic advantages of a Eurohypothec are sufficiently attractive. The impetus for a Euromortgage comes from a belief that a common mortgage form would promote an integrated mortgage credit market across the European Union, enabling lenders to secure a number of loans, which could be made in different member States, against land assets that are held in more than one jurisdiction. Such developments may be very attractive to large institutional lenders and to investors in mortgaged-backed securities, but they do not provide immediate advantages to many borrowers—particularly consumers—unless the benefit to lenders is passed on through the greater competition and flexibility that an integrated market is expected to produce.[65]

[61] Mortgage Credit Foundation (2005).

[62] Although Watt argues that this obstacle can be overcome: see 'The Eurohypothec and the English Mortgage' (2006) 13 MJECL 173, 185–8.

[63] Ibid, at 188–91.

[64] Ibid, at 191–2. We will explore this protection in the next chapter.

[65] Ibid, at 179–81.

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QUESTIONS

1. What is the difference between a 'mortgage' and a 'charge'? Why is the legal charge by way of mortgage described as a hybrid security?
2. In what circumstances may an equitable form of security interest be created?
3. What advantages would there be if the Law Commission's recommended changes to the form of land mortgages were enacted?
4. Do you agree that the concept of an equity of redemption has outlived its usefulness?

FURTHER READING

Clarke, 'Security Interests in Property' in *Property Problems: From Genes to Pension Funds* (ed Harris, London: Kluwer, 1997)

Law Commission Report No 204, *Land Mortgages* (1991)

Nield, 'Charges, Possession and Human Rights: A Reappraisal of Section 87(1) Law of Property Act 1925' in *Modern Studies in Property Law: Vol 3* (ed Cooke, Oxford: Hart, 2005)

Oldham, 'Mortgages' in *Land Law: Issues, Debates, Policy* (ed Tee, Devon: Willan, 2002)

Sugarman and Warrington, 'Telling Stories: Rights and Wrongs of the Equity of Redemption' in *Property Problems: From Genes to Pension Funds* (ed Harris, London: Kluwer, 1997)

Watt, 'Mortgage Law as a Legal Fiction' in *Modern Studies in Property Law: Vol 3* (ed Cooke, Oxford: Hart, 2007)

Watt, 'The Eurohypothec and the English Mortgage' (2006) 13(2) MJECL 173

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PROTECTION OF THE BORROWER

CENTRAL ISSUES

1. Protection of borrowers operates through a number of mechanisms. Regulation of the credit market seeks to ensure that lenders treat borrowers fairly. In addition, direct duties operate to try and protect borrowers against unfairness in the creation and operation of the mortgage transaction and substantive unfairness of the mortgage terms. The level of protection differs according to the nature of the borrower and the type of security transaction.
2. The home mortgage market is regulated through the Financial Services and Markets Act 2000 and the Consumer Credit Act 1974, following principles of decentred regulation to encourage responsible lending and responsible borrowing.
3. A mortgage may be set aside because of procedural unfairness. There are a number of doctrines that underpin procedural fairness, including duress, undue influence, misrepresentation, and unconscionable bargain. In recent years, undue influence has been employed to try to ensure the procedural fairness of collateral mortgages over the family home to fund a business loan.
4. The control of mortgage terms seeks to balance the freedom of the parties to contract against a concern that borrowers' financial situation makes them vulnerable to exploitation.
5. Equitable protection has been provided by controls against penalties, and oppressive and unconscionable terms, as well as by protection of the borrower's equity of redemption.
6. Statutory consumer protection now provides additional protection to domestic borrowers.

1 INTRODUCTION

In this chapter, we will be concentrating on the position of the borrower, who is often considered to be the more vulnerable party. In modern commercial lending, that is not always the case where the borrower is a profitable company, the liquidity of which is maintained with the assistance of an overdraft facility from its bankers, or which requires finance to fund the expansion of its flourishing business. Such companies can not only source the most

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competitive terms from financiers, but can also afford the services of lawyers and other advisers to ensure that their position is protected. Other companies may not be so fortunate if they are small and struggling to start a business, or to maintain profitability in a competitive marketplace. They may have few assets to offer as security and may be only able to secure finance if their directors or shareholders are prepared to offer their personal assets as security, or are willing to expose themselves to personal liability through the grant of a personal guarantee.

In the domestic lending market, a distinction needs to be drawn between those who wish to use their earning power to buy a home, and the individual who is in financial difficulties and needs to raise money or consolidate his or her immediate liabilities. The former will be able to choose from a number of mainstream banks and building societies, which are prepared to offer competitive terms because the risk of default is low. The borrower's earnings will meet the instalment repayments and the loan, in any event, will be secured against a property. This type of borrower is only likely to be exposed either from an unanticipated rise in interest rates, or from an unforeseen decline in his or her earnings or the housing market. It is the borrower who is in urgent need of funds that is the most vulnerable. He or she is unlikely to be attractive to high street lenders and will have to resort to the secondary mortgage lenders, which charge higher rates of interest and demand more onerous terms to meet the higher risk that is inherent in this type of lending. These borrowers are also unlikely to have the luxury of choice or to have the strength of bargaining position to negotiate terms.

This diversity in types of borrower and the circumstances in which they require funds leads to a need to draw distinctions in the appropriate controls. Whitehouse has noted that mortgage law itself has changed little over the decades but has managed to accommodate changes in the socio-economic context in which it operates by looking to other methods of control.

Whitehouse, 'A Longitudinal Analysis of the Mortgage Repossession Process 1995-2010: Stability, Regulation and Reform' in *Modern Studies in Property Law Vol 6* (ed Bright, 2011, p 151)

> The English law of mortgage is remarkable [...] Its stubborn retention of archaic terms and concepts operate in sharp contrast to the ever changing world of finance which it inhabits. Most impressive of all, however, is its capacity for stability in the face of fundamental shifts in the socio-economic context, to put the legal device of the mortgage to new uses without the need to alter its fundamental doctrinal characteristics. The stability apparent within the law of mortgage [...] derives from a concern to establish requirements as to formality and procedure, leaving much of substance of the mortgage relationship to be 'regulated' through more malleable processes such as contractual 'negotiation', 'discretion' and 'soft law.'

The measures that we will need to examine in this chapter fall into a number of categories. We will first consider the legal regulation of the consumer lending market, which has grown considerably in recent years with the Consumer Credit Act 1974 (CCA 1974), which was subject to major amendment in 2006, and the Financial Services and Markets Act 2000 (FSMA 2000). We will then consider the protection afforded to the borrower in the creation of the mortgage. We will briefly consider the common vitiating factors that may lead to the avoidance of a mortgage, before examining the application of undue influence to collateral mortgages of the family home to secure a business loan. Finally, controls over the terms of the mortgage itself must be considered. We will look initially at the common law, equitable,

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and statutory sources of these controls. Here, equity has long shown a concern to ensure that the mortgage is redeemable by the borrower and that the mortgage terms themselves are not oppressive or unconscionable. Control over mortgage terms and the mortgage relationship may also be exerted as a result of regulatory and statutory measures, although this intervention is largely confined to the consumer lending.

We will leave until the following chapter the protection afforded to a borrower where the lender enforces its rights and remedies under the mortgage itself.

2 MARKET REGULATION

Recent decades have seen significant changes in the domestic mortgage market and its regulation. Building societies, once the predominate source of home finance, were deregulated during the 1990s triggering a wave of building society demutualizations and mergers. In this process larger building societies converted to become banks. Other high street banks and lenders also entered into the lucrative home mortgage market. This increased competition saw a dramatic rise in the availability of credit to fund home ownership and other consumer expenditure, which suffered an equally dramatic decline with the global credit crunch of 2007/2008—one of the causes of which was the expansion of credit through irresponsible lending. Lending and borrowing levels are yet to recover in the face of slow domestic growth and the threat of recession.

In the context of the promotion of private home ownership, Whitehouse has noted the rise in regulation of mortgages through market forces.

Whitehouse, 'The Homeowner: Citizen or Consumer?' in *Land Law: Themes and Perspectives* (eds Bright and Dewar, 1998, p 189)

[. . .] [T]he promotion of home-ownership has allowed central government to replace direct state intervention with the regulation offered by the market system. The private contractual basis of mortgage finance makes it eminently suitable for regulation by the market. Because of the varied types of accommodation available within the owner-occupied sector and the wide range of mortgagees willing to offer different types of mortgage products, the state could reduce its intervention within the housing system and allow market forces to regulate the activities of mortgagors and mortgagees.

The justification for the reduction in direct state intervention within the housing system is based upon an 'idealistic' view of consumerism which extols the benefits of market forces as the guardians of choice, competition, and accountability. The shift in emphasis away from citizenship and towards consumerism may seem uncontroversial, particular as the term consumer is often combined with concepts of 'rights', 'protection', and 'legislation'. The rhetoric of consumerism implies that, where the market fails to provide a sufficient degree of choice and accountability, the state will intervene, on the consumer's behalf, by implementing legislation which corrects the failings in the market. The 'protection' afforded to homeowners, therefore is claimed to derive from a combination of market regulation and direct legal intervention [. . .]

Choice is a fundamental aspect of the 'idealistic' view of market regulation promoted by the rhetoric of consumerism, if consumers can exercise choice, then they can also determine which suppliers survive within the market. This provides consumers with a degree

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of influence which ensures that suppliers of goods and services operate according to the demands of consumers. In order for there to be choice, however, there must be a range of goods and services offered by different suppliers. In other words, competition is essential to the effective operation of a free market. In order to ensure competition, the former Conservative government sought to 'deregulate' the mortgage market, thereby encouraging financial institutions other than building societies to offer mortgage finance.

At the time that Whitehouse was writing, the market was largely self-regulated. The Council of Mortgage Lenders, the influential trade organization of lending institutions within the residential mortgage market, had a Statement of Practice to which its members were expected to adhere. The government did intervene through the CCA 1974, but only where the loan did not exceed £25,000—a limit that became increasingly irrelevant as property prices increased. The picture has now changed, with what has been termed a 'decentred regulatory approach' of the mortgage market, through the enactment of the FSMA 2000 and major revisions to the 1974 Act.[1]

Decentred regulation is founded upon premise of rational and self-interested players. For instance, it is assumed that in credit markets lenders will make responsible lending decisions that minimize the risk of bad debts and that borrowers will choose credit terms best suited to their needs. Regulation of the credit market seeks to promote this rational decision making by creating market conditions in which borrowers receive standardized information upon which to base responsible borrowing choices and lenders are expected to adhere to benchmarks of good practice including an expectation that they will make responsible lending decisions to minimize the risk of default.

Ramsay, 'Consumer Law, Regulatory Capitalism and the "New Learning" in Regulation' (2006) 28 Sydney LR 9, 12–13

A decentred regulatory approach might include initiatives that aim to 'responsibilise' both the supply and demand side of consumer markets, such as the current reforms to consumer credit law in the UK and Europe that are based on the twin pillars of 'responsible lending' and 'responsible borrowing'. Corporate social responsibility normally may contribute to the responsibilisation of suppliers. Responsibilisation of consumers seeks to reconstruct the consumer as a regulatory subject, a project that is both innovative and complicated. Within the traditional market model, consumer sovereignty was the goal of consumer policy. However, there was little concern for how consumers exercised their sovereignty. By contrast, the new learning on regulation positions the consumer as an important regulatory subject perceived as crucial to achieving national goals such as greater competitiveness. The 'responsibilisation' of the consumer is being pursued in areas such as credit and financial services, where governments are investing heavily in such projects to ensure that individuals become responsible consumers through the use of information, the development of financial capability, and financial literacy programs. These programs often make heroic assumptions about the ability of consumers to use and process information on market choices and their ultimate results remain uncertain and difficult to measure.

[1] There is a considerable literature on the role and impact of this new approach to regulation: see Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-regulation in the "Post-Regulatory" World' (2001) 54 CLP 103; Black, 'Tensions in The Regulatory State' (2007) PL 58; Baldwin, 'Is Better Regulation Smarter Regulation?' (2005) PL 485.

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The twin goals of responsible lending and responsible borrowing are evident in both the CCA 1974 and FSMA 2000, the salient provisions of which we examine below. Whilst based upon similar regulatory principles, these two pieces of legislation do mark a division in the regulation of the domestic mortgage market. To some extent, this division can be attributed to different areas of the consumer mortgage market. Even so, it has attracted criticism for resulting in consumer confusion, differing levels of borrower protection and unnecessary additional compliance costs for lenders.[2] There are proposals to realign this regulatory divide to bring all consumer credit under one regulatory body.[3] Other proposals have recommended that at least credit secured by a mortgage should be supervised by a single regulator operating a regime following the FSMA 2000 model.[4]These proposals flow from frenetic government and regulatory activity to stabilize credit markets after the debacle of the credit crunch, which was blamed largely upon the ineffective regulation of the financial markets including the banks and other domestic lenders.[5]

Before we look in more detail at the CCA 1974 and the FSMA 2000, we need to say a word about the European dimension. We saw in the previous chapter European proposals for a European wide form of mortgage. There have also been developments in the regulation of credit in the European single market. The European Directive on Consumer Credit was adopted in April 2008 to promote the integration of consumer credit and provide for common levels of consumer protection.[6] The Directive has been incorporated into domestic law with effect from the beginning of February 2011; however, it does not extend to secured credit over land. [7]In relation to security interests over land the European Commission in March 2011 made recommendations for a Mortgage Credit Directive,[8] which proposes to extend the need for standard information disclosure, adequate explanations to borrowers and measures to enhance responsible lending to all residential mortgages within the European Union. As we will see, these consumer protection principles are already evident in the domestic regulation of mortgage credit, although their detailed implementation would inevitably be effected should the Directive be enacted.

2.1 FINANCIAL SERVICES AND MARKETS ACT 2000, AND REGULATED MORTGAGE CONTRACTS

The FSMA 2000 established the Financial Services Authority (FSA) as the single regulatory authority for the banking, credit securities, and insurance industry. With effect from 31 October 2004, the FSA took over responsibility for regulated mortgage contracts, and from 6 April 2007, the FSA become responsible for home purchase plans[9] and home reversion plans.[10] The regulation of sale and leaseback transaction also became the responsibility of

[2] Oldham, 'Mortgages' in *Land Law: Issues, Debates, Policy* (ed Tee, 2002) p 207 and Nield, 'Responsible Lending and Borrowing: Whereto Low Cost Homeownership' (2010) 30 LS 610.

[3] Current Government proposals are for the creation of a new Consumer Protection and Markets Authority; see HM Treasury, A new approach to financial regulation: judgment, focus and stability (July 2010) and HM Treasury and Department for Business Innovation & Skill, A Consultation on Reforming the Consumer Credit Regime (December 2010).

[4] See HM Treasury, A Consultation on Mortgage Regulation (December 2009).

[5] See for instance FSA, The Turner Review (March 2009).

[6] Directive 2008/48/EC.

[7] The Consumer Credit (EU Directive) Regulations 2010 SI 2010/1010 as amended by SI 2010/1969.

[8] IP/11/383.

[9] That is, Islamic mortgages: see Chapter 28, section 6.1.

[10] That is, equity release schemes: see Chapter 28, section 6.3.

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the FSA in 2009. FSA supervision extends both to mortgage lenders and mortgage brokers who provide advice and arrange mortgages.

2.1.1 Regulated mortgage contracts

Regulated mortgage contracts are defined by the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.[11]

Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, art 61 (as amended)

[. . .]

(a) a contract is a "regulated mortgage contract" if, at the time it is entered into, the following conditions are met—

(i) the contract is one under which a person ("the lender") provides credit to an individual or to trustees ("the borrower");

(ii) the contract provides for the obligation of the borrower to repay to be secured by a first legal mortgage on land (other than timeshare accommodation) in the United Kingdom;

(iii) at least 40% of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person;

[. . .]

The FSA's remit thus covers most home purchase loans that are secured by a first legal charge over the borrower's home.[12] It will also cover first legal mortgages of second homes and may also extend to loans made to small businesses, where the loan is secured by a first charge over the business proprietor's home.[13] Buy-to-let mortgages are not within the definition; they fail to satisfy para (a)(iii). The reference to land held on trust and occupied by beneficiaries reflects the co-ownership and successive ownership structures that we considered in Chapters 16 and 20.

2.1.2 The Financial Services and Markets Act 2000 regulatory framework

One of the FSA's statutory objectives is '*the protection of consumers*'.[14] In pursuing that objective, the FSA's role reflects decentred regulation. The aspiration is that borrowers will be 'treated fairly' by requiring lenders to follow published standards of practice, which (inter alia) oblige lenders to make responsible lending decisions and to provide borrowers with accurate information, in the hope that borrowers are better placed to make responsible borrowing decisions.

The means by which the FSA is to achieve that objective is, firstly, by controlling those who can conduct regulated mortgage business (known as prudential control), and, secondly,

[11] SI 2001/544.

[12] Equitable mortgages are not regulated under the Financial Services and Markets Act 2000: see Oldham, 'Mortgages' in *Land Law: Issues, Debates, Policy* (ed Tee, 2002) p 191.

[13] The business gross annual turnover must not exceed £1m.

[14] Financial Services and Markets Act 2000, s 2(2)(c).

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by influencing the way in which mortgage business is conducted by requiring compliance, through a range of disciplinary and enforcement powers, with published statements of principles exemplified through supporting codes of conduct and detailed rules (known as conduct of business control).

A financial institution may not carry out regulated mortgage business unless it is authorized by the FSA, or is specifically exempt.[15] If it does so, it is guilty of a criminal offence[16] and the transaction itself is unenforceable, except to the extent that the court is satisfied that it is just and equitable to order enforcement.[17]

Any permission to carry out regulated mortgage business is subject to the statements of principle, codes of practice,[18] and rules that the FSA may make.[19] The statements, codes, and rules represent a three-tier strata of regulatory guidance. The statements of principle set out the overarching ethos governing the conduct of regulated mortgage business; the codes of practice provide examples of the types of activity that, on the one hand, comply with and, on the other, breach the relevant principles; but it is the rules that set out the detailed regulations that govern the conduct of mortgage business itself. The interrelationship between the principles and the rules was described in *R. (on the application of British Bankers Association) v FSA*[20] in the following terms:

Ouseley J

At 162

The Principles are best understood as the ever present substrata to which the specific rules are added. The Principles always have to be complied with. The specific rules do not supplant them and cannot be used to contradict them. They are but specific applications of them to the particular requirements they cover. The general notion that the specific rules can exhaust the application of the Principles is inappropriate. It cannot be an error of law for the Principles to augment specific rules.

In preparing the principles, codes, and rules, the FSA is required to consult with both the mortgage industry (e.g. the Council of Mortgage Lenders) and with bodies representing the interests of borrowers (e.g. the National Consumer Council).[21] The principles,[22] codes, and rules[23] are contained in the FSA Handbook.

The FSA may take disciplinary action for a breach of a statement of principle, a code of conduct, or a breach of the rules.[24] In addition, although the enforceability of the transaction

[15] Ibid, s 19. The FSA may also prohibit an employee or agent, who carries out regulated mortgage business on behalf of an authorized person, from so acting where that individual is not a 'fit or proper' person: see ibid, s 56. Acting in breach of a prohibition does not affect the enforceability of the transaction (s 20(1)), but is a criminal offence (s 56(4)), and a breach of statutory duty (s 71).

[16] Ibid, s 23.

[17] See ibid, ss 26 and 28. For example, *Helden v Strathmore Ltd* [2011] EWCA Civ 542.

[18] Ibid, s 64. [19] Ibid, s 138. [20] [2011] EWHC 999. [21] Ibid, ss 8–10.

[22] See FSA Handbook, Principles for Business (PRIN), available online at http://fsahandbook.info/FSA/html/handbook/PRIN; FSA Handbook, The Statement of Principles for Approved Persons (APER 2), available online at http://fsahandbook.info/FSA/html/handbook/APER/2.

[23] FSA Handbook, Code of Practice for Approved Persons: General (APER 3), available online at http://fsahandbook.info/FSA/html/handbook/APER/3.

[24] Financial Services and Markets Act 2000, ss 64(8) and 66. The FSA has taken enforcement action against several lenders for irresponsible lending and unfair treatment of customers in arrears see Kensington Mortgage Co Ltd (Final Notice: 12 April, 2010), J Cummings (Final Notice: 20 October, 2010) and DB UK Bank Ltd (Final Notice: 15 December, 2010).

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is unaffected, a borrower may take direct action for a breach of statutory duty where his or her lender has breached the rules but there is no individual course of action for breach of a statement of principle or a code of conduct.[25]

2.1.3 Mortgage and home finance: the Mortgage Conduct of Business Sourcebook (MCOB)

The rules regulating mortgage business are set out in that part of the Handbook entitled the Mortgage Conduct of Business Sourcebook (MCOB).[26] The MCOB regime adopts a 'cradle to grave' approach, which governs the whole course of the borrower's relationship with his or her lender. There are rules governing the marketing of mortgage products[27] and the provision of information through all stages from the first visit of a potential borrower to a mortgage provider, through to the pre-application illustration of the available loan terms[28] and the mortgage offer itself,[29] with continuing requirements for information to be provided on the actual grant of the loan and periodically during the course of the mortgage term.[30] Further rules call upon the lender to lend responsibly in the light of a prospective borrower's ability to pay.[31] If the borrower should fall into arrears, there are rules that regulate how the mortgage provider should respond, which we will consider in the next chapter.[32] The rules are intended to meet the overarching statement of principles that call upon lenders '*to pay due regard to the interests of its customers and treat them fairly*',[33] '*to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading*',[34] and to '*take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment*'.[35]

The twin principles of responsible lending and responsible borrowing are enshrined within a lender's duty to provide information to the borrower in an intelligible and prescribed form, which is intended to enable borrowers to compare different mortgage products and make informed choices about which particular mortgage terms will best suit their circumstances. Perhaps the most significant piece of information is the pre-application illustration, known as the 'Key Facts illustration', which must be updated when the mortgage offer is made. This illustration must be in the prescribed form, to facilitate comparison between different mortgage products, which includes details of (inter alia) the type of mortgage, the overall

[25] Ibid, s 150. See, for example, cases against investment advisers who are also regulated by the FSA—*Zaki v Credit Suisse (UK) Ltd* [2011] EWHC 2422, *Rubenstein v HSBC Bank Plc* [2011] EWHC 2304 and *Bank Leumi (UK) Plc v Wachner* [2011] EWHC 656.

[26] FSA Handbook, Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB), available online at http://fsahandbook.info/FSA/html/handbook/MCOB.

[27] FSA Handbook, Financial Promotion of Qualifying Credit and of Home Reversion Plans (MCOB 3), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/3.

[28] FSA Handbook, Pre-application Disclosure (MCOB 5), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/5.

[29] FSA Handbook, Disclosure at the Offer Stage (MCOB 6), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/6.

[30] FSA Handbook, Disclosure at Start of Contract and After Sale (MCOB 7), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/7.

[31] FSA Handbook, Responsible Lending, and Responsible Financing of Home Purchase Plans (MCOB 11), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/11.

[32] FSA Handbook, Arrears and Repossessions: Regulated Mortgage Contracts and Home Purchase Plans (MCOB 13), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/13.

[33] Principle 6. [34] Principle 7. [35] Principle 9.

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cost of the mortgage, the monthly repayments, any arrangement fee, and any charges made for early repayment.[36]

Further rules detail how the annual percentage rate (APR) of interest is to be calculated,[37] and provide that a borrower must be given time to consider the Key Facts illustration and the mortgage offer.[38] The rules also stipulate that any charges imposed—for example, rates of interest or in the event of default or early repayment—must not be excessive.[39] This need for clear and consistent information is laudable but the experience of the credit crunch has demonstrated its deficiencies in protecting borrowers.

Nield, 'Responsible Lending and Borrowing: whereto low cost home ownership?' (2010) 30 LS 610 (footnotes omitted)

Under the FSMA, the pre-application key facts illustration [. . .] has been described by the FSA as the 'cornerstone' of mortgage regulation. However, even before the credit crunch, there was evidence from both the FSA and Citizens Advice that suggested weakness in disclosure. Their research found that certain mortgagors, particularly within the sub-prime market, did not compare different mortgage products or even understand some of the fundamental features of mortgage borrowing and thus could not play their part as a rational consumer [. . .]

There is growing recognition that a mortgagor's decision to borrow may not be made on solely rational grounds but is a more complex process that is also influenced by factors that have inspired the development of behavioural economics. For instance, individuals can tend to be over optimistic and even when warned, for instance, that they may lose their house if they do not keep up their mortgage payments, do not believe that they will default and face repossession. Individuals' assessment of risk also may not be rational, with dramatic events which attract high media attention being overestimated as more likely to happen as against less vivid risks that excite only muted attention. Hyberbolic discounting suggests that a mortgagor's ability to value discounted mortgage rates, arrangements fees, pre-payment penalties and the like may not be rationally consistent over the time frames in which these charges operate [. . .]

The FSA Review notes that mortgagors' (as opposed to other consumers') decisions are subject to particular behaviours which can reduce mortgagors' caution and entice them into borrowing decisions which are not best suited to their interests. Mortgages can appear deceptively cheap products. Considerable sums are received for relatively small periodic repayments which, being repaid over an extended term, contribute to the apparent affordability of the borrowing.

Mortgagors are motivated to borrow by immediate want or need which will lead them to focus on the end result. In contrast to other financial products, the mortgage (like other credit) is not always seen as the product being bought and sold but as a means to an end. The focus is then on the asset purchased. In relation to first legal charges, this will often be

[36] FSA Handbook (MCOB 5).

[37] FSA Handbook, Annual Percentage Rate (MCOB 10), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/10.

[38] FSA Handbook, '2.4 High pressure sales: regulated mortgage contracts and home reversion plans', Conduct of Business Standards: General (MCOB 2), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/2/4.

[39] FSA Handbook, Arrear and Repossessions: Regulated Mortgage Contracts and Home Purchase Plans (MCOB 12), available online at http://fsahandbook.info/FSA/html/handbook/MCOB/12.

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the mortgagor's prospective home. Second-charge borrowing might fund a home improvement or other substantial expenditure or it might be utilised to avoid default when existing unsecured loans are consolidated.

Thus, although the borrowers are provided with information, they may find it difficult, if not impossible, to adequately assess the implications of that information to their particular circumstances and so fail to make responsible choices. The financial education of borrowers is a policy aim with the Consumer Financial Education Body (now known by the catchier title of The Money Advice Service) established by the Financial Services Act 2010. There is a host of leaflets from various organizations to provide guidance, but these are loose measures that depend upon the willingness and ability of vulnerable borrowers to use them effectively.

The FSA's reaction to the credit crunch has seen a stricter approach towards prudential regulation of licenced lenders and a shift towards greater paternalism in setting conduct of business standards. There is an expectation that lenders should take greater responsibility with talk of product regulation, affordability checks and a clearer approach to the provision by lenders and their brokers of information and advice to borrowers.[40]

MCOB 11 requires lenders '*to show that before deciding to enter into, or making a further advance on, a regulated mortgage contract, or home purchase plan, account was taken of the customer's ability to repay*'.[41] This assessment is to be made against the lender's written policy, which is to look primarily to the level of borrower's actual or reasonably anticipated income. It is clear that before the credit crunch some lenders failed to lend responsibly.[42] They were prepared to offer mortgages with high loan to value [of the security] ratios and used higher and higher multiplies of borrowers' income to set lending ceilings. Lenders were also lax in checking the borrowers' ability to pay and too keen to offer mortgages without verifying the individual borrower's income. The credit crunch has brought some sanity back into the market with falls in loan to value and loan to income ratios as well as more stringent checks upon the borrower's income. These moves foreshadow recommendations from the FSA to amend MCOB 11.[43] However, this restriction in mortgage finance has excluded many, particularly first time buyers, from the housing market and left the aspiration of home ownership out of reach for many first time buyers and lower income families.[44]

2.1.4 Financial Service Ombudsman

Redress through the courts is not the only route for an aggrieved borrower. The FSA Handbook requires an authorized lender to have in place a complaints-handling process that complies with the requirements set out in the Handbook.[45] A borrower's first step is thus to resolve his or her complaint directly with the lender. His or her next step may then be to approach the Financial Services Ombudsman (FSO), which is established under Part XVI

[40] FSA, The Turner Review (March 2009); FSA, Mortgage Market Reviews DP09/3, CP10/16; FSA, Responsible Lending (July 2010) and FSA, CP10/28 Distribution and Disclosure (November 2010). See also Nield, 'Responsible Lending and Borrowing: whereto low cost home ownership?' (2010) 30 LS 610

[41] FSA Handbook, '11.3.1 Customer's ability to pay' (MCOB 11).

[42] FSA, The Turner Review (March 2009). [43] Ibid.

[44] Nield, 'Responsible Lending and Borrowing: whereto low cost home ownership?' [2010] LS 610.

[45] FSA Handbook, Dispute Resolution: Complaints (DISP), available online at http://fsahandbook.info/FSA/html/handbook/DISP.

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of the FSMA 2000 as a body that is independent of the FSA, to provide an alternative means of resolving disputes.[46]

The FSO may consider complaints made by borrowers and may call upon the lender to provide the requisite information to enable them to do so.[47] The FSO may make an award based upon what is fair, just, and reasonable, rather than being bound to apply the strict legal rules,[48] with any compensation subject to a statutory cap of £100,000.[49] That award is binding upon the lender and enforceable as such in the same way as a court judgment. The borrower, however, may decline the FSO's award and continue to pursue his or her claim through the courts. [50]

The FSO provides a practical route through which to resolve relatively small and straightforward disputes. It has the advantage of being free at the point of entry and, with speedier and less formal methods of working, more accessible to many borrowers. [51] The mis-selling of endowment mortgages and, more recently, payment protection insurance have been major sources of complaints to the FSO.[52] Complaints on the mis-selling of endowment mortgages arose either because this type of mortgage was an inappropriate product for the particular borrower or because the lender inaccurately projected the sum payable on maturity of the endowment policy; which was intended to meet the capital sum repayable at the end of the mortgage term. As a result the borrower faced a shortfall and had to try and find the balance from his or her own resources. Payment protection insurance[53] complaints arose because borrowers were sometimes unaware that they had a choice whether to take out such insurance; which purports to cover the risk of loss if the borrower is unable to meet their repayments because of illness or unemployment. Furthermore, the premiums and associated commission, which lenders' affiliated insurance companies could earn on selling these policies, were often substantial.

2.2 CONSUMER CREDIT ACT 1974 (AS AMENDED)

The CCA 1974 was passed following the recommendations of the Crowther Committee, which, in 1971, undertook a comprehensive review of consumer credit.[54] The Act brought the regulation of most different forms of credit available to individuals (including credit cards, hire purchase, and unsecured and secured loans) under one legislative umbrella. Mortgages were not the primary target, because they were thought to be already adequately

[46] See generally Morris and James, 'The Financial Ombudsman Service: A Brave New World in "Ombudsmanry"' [2002] PL 640; Ferran, 'Dispute Resolution Mechanisms in the UK Financial Sector' (2002) 21 CJQ 135.

[47] Financial Services and Markets Act 2000, s 232.

[48] Ibid, s 229 and *R (on the application of IFG Financial Services Ltd v FSO* [2005] EWHC 1153. See also *R (on the application of the British Bankers Association) v FSA* [2011] EWHC 999 for the inter-relation between the FSA principles, codes and rules and the FSO jurisdiction.

[49] *Bunney v Burns Andersen Plc* [2007] EWHC 1240.

[50] *Andrews v SBJ Benefit Consultants* [2010] EWHC 2875.

[51] This dispute resolution process has been held compliant with Art 6 of the European Convention on Human Rights see *Heather Moor & Edgecomb Ltd v UK* (2011) 53 EHRR SE18.

[52] Mortgage endowment complaints accounted for 49 per cent of complaints in 2006/07 and payment protection insurance accounted for 51 per cent of complaints in 2010/11; see FSO, *Annual Reviews* available online at http://www.financial-ombudsman.org.uk.

[53] Often taken out with unsecured loans but also sometimes with mortgages.

[54] Cmnd 4596, 1971.

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protected. However, mortgages could fall subject to the CCA 1974 if they did not exceed the £25,000 ceiling.

The rapid growth and changing face of the consumer credit market in the following years led to a review of consumer credit and, in 2003, the government issued a White Paper, *Fair, Clear and Competitive: the Consumer Credit Market in the 21st Century*,[55] which resulted in the Consumer Credit Act 2006 (CCA 2006). This Act substantially amends the 1974 Act, so as to bring more mortgages over land within its control.

2.2.1 Mortgages within the Consumer Credit Act 1974 (as amended)

The CCA 1974 (as amended) only protects individual borrowers.[56] It does not apply to companies, although loans for business purposes are subject to regulation where the business is carried on by a sole trader, or where a partnership comprises less than three partners, and the loan does not exceed £25,000.[57] The £25,000 limit no longer applies to other loans entered into after April 2008.[58]

Regulated mortgage contracts, which, as we have seen, are regulated by the FSA, are excluded from dual regulation under the 1974 Act.[59] It is thus the secondary mortgage market that is largely the subject of regulation, unless the mortgage is made to a lender that is expressly exempt from control: for example, local authorities, building societies regulated by the Building Societies Act 1986, or lenders licensed under the Banking Act 1987.[60]

It is possible for a borrower who qualifies as a 'high net worth debtor' to opt out of protection under the 1974 Act.[61] The mortgage must contain a statement to that effect made by the borrower and must be accompanied by a statement of high net worth—that is, that the debtor had an income in the previous year of not less than £150,000 and/or net assets of not less than £500,000.[62] The reasoning behind this provision is the belief that such borrowers should be able to look after themselves.

Even so, the controls over unfair terms and practices contained in ss 140A–140C (see below) apply to loans to exempt lenders, high net worth borrowers and business loans over £25,000. Sections 140A–140C also apply where sums are outstanding under a consumer credit agreement entered into before 6 April 2007, when the provisions came into force. But regulated mortgage contracts that are subject to separate regulation under the FSMA 2000 are not caught by ss 140A–140C.[63]

Brown has created a useful flow diagram (Figure 27) to demonstrate how to ascertain whether or not a particular mortgage falls within the 1974 Act.[64]

[55] Cm 6040, 2003. [56] Consumer Credit Act 1974 (as amended), s 8.

[57] Ibid, s 16B. It was intended that buy-to-let mortgages would be excluded from regulation under the 1974 Act because of this limitation, but such mortgages may not escape regulation where the borrower is not conducting a business.

[58] Second or equitable mortgages in excess of £25,000 were unregulated prior to April 2008.

[59] Consumer Credit Act 1974 (as amended), s 16(6C). First mortgages entered into before 31 October 2004 are not regulated mortgage contracts, but will be exempt from regulation under the 1974 Act where they are made by a building society regulated by the Building Societies Act 1986 or where the lender is licensed under the Banking Act 1987.

[60] Ibid, s 16(1). [61] Ibid, s 16A.

[62] Consumer Credit (Exempt Agreements) Order 2007, SI 2007/1168.

[63] Consumer Credit Act 1974 (as amended), s 140A(5).

[64] Brown, 'The Consumer Credit Act 2006: Real Additional Mortgagor Protection?' [2007] Conv 325.

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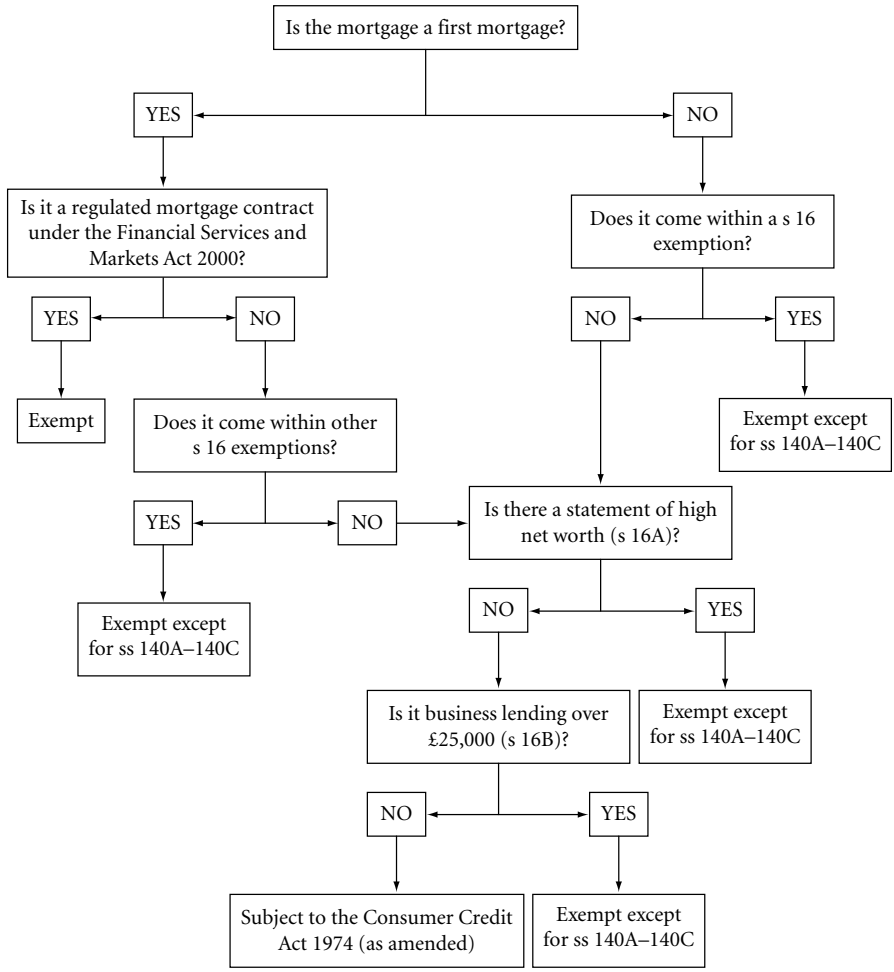

Figure 27 Brown's flow diagram

The target for control under the 1974 Act over the mortgage market is generally secondary lenders who are prepared to lend to borrowers on the security of a subsequent mortgage—sometimes known as equity release funding because the loan is secured on the unencumbered value of the borrower's property. The purpose of the loan is generally not to fund a house purchase, which is likely to be secured by a first legal mortgage and thus subject to regulation under the FSMA 2000; the purpose of the loan is more likely to be to consolidate the borrower's debts—for example, on credit cards, an overdraft, and hire purchase agreements—by repaying these debts with a single loan secured by a subsequent mortgage over the borrower's home. Alternatively, the loan may be to fund other expenditure that is of such magnitude that the lender is not prepared to lend on an unsecured basis. Such borrowing is often unattractive to high street banks and building societies, and is made instead by secondary lenders, which charge higher rates of interest with more onerous default charges often with repayment over a short term.

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2.2.2 The Consumer Credit Act 1974 (as amended) regulatory framework

The government's White Paper, *Fair Clear and Competitive*, set out its hope to '*encourage an open and fair credit market where consumers can make fully informed decisions and business can compete aggressively on a fair and even basis*'.[65] Here, again, we see the rhetoric of decentred regulation, and responsible lending and responsible borrowing. This responsibility is to be encouraged by a transparent market in which borrowers are provided with clear and consistent information upon which they can exercise choice and can make sensible financial decisions. Fairness in the market is to be achieved by the control of those who can lend through a licensing and regulatory system operated by the Office of Fair Trading (OFT), and through legislation that controls market practices and the transaction itself, under the supervision of both the OFT and the court.

Lenders must be licensed by the OFT in order to make a regulated consumer credit agreement and to take a mortgage to secure any such agreement.[66] An unlicensed lender commits a criminal offence[67] and any mortgage entered into by an unlicensed lender is only enforceable by order of the OFT.[68] The OFT also has power to suspend or revoke a licence,[69] and to impose conditions upon a licensee as to the conduct of its business.[70] To that end, the OFT is granted investigative powers so that it can monitor the business of licensed lenders.[71]

There is no equivalent to the MBOC Sourcebook to govern mortgages under the CCA 1974, but the OFT may issue regulations and guidance to its licensed lenders.[72] The OFT is also empowered to produce codes of conduct to promote '*good practice in the carrying out of activities which may affect the economic interests of consumers in the United Kingdom*'.[73] It has been accused of failing to provide adequate, comprehensive and current guidance, and to put in place an effective monitoring and compliance strategy.[74] The OFT is taking steps to rectify this omission. Its *General Guidance on Fitness of Licensed Lenders* was updated in January 2008.[75] In this guidance, the OFT announced that, in assessing a lender's fitness, it will require a credit risk profile, where the lender is engaged in sub-prime lending, and will take into consideration any breach of the FSA rules and principles. The OFT has also issued guidance on Second Charges[76] and Irresponsible Lending[77] and is consulting on providing guidance on Debt Management[78] and Collection.[79]

Loan agreements and supporting mortgages falling within the terms of the CCA 1974 are regulated by detailed and comprehensive rules covering the whole process, from advertisement, through creation of the agreement and mortgage, to their enforcement in the event of default. This cradle-to-grave approach is similar to, but more prescriptive than, the requirements governing regulated mortgage contracts under the FSMA 2000. Furthermore, the consequences of non-compliance are more far-reaching.

The CCA 1974 prescribes the information that must be provided to the borrower prior to the entry into the agreement and mortgage,[80] during the term,[81] and in the event of any default.[82] The form and execution of the agreement,[83] and the supporting mortgage,[84] must also comply with the requirements of the Act. In addition, the process of completing the

[65] Cm 6040, 2003, [1.69]. [66] Consumer Credit Act 1974 (as amended), Pt III. [67] Ibid, s 396.
[68] Ibid, s 40. [69] Ibid, s 32. [70] Ibid, ss 33A–33E.
[71] See ibid, ss 36B–36F and Part XI generally. [72] Ibid, ss 26, 33A–33E.
[73] Enterpise Act 2002, s 8. [74] Citizens Advice (2007). [75] OFT 969 (2008).
[76] OFT 1105 (July 2009). [77] OFT 1107 (March 2010 updated February 2011).
[78] OFT 1138con (June 2011). [79] OFT 664con (March 2011).
[80] Consumer Credit Act 1974 (as amended), s 55. [81] Ibid, ss 77–78A.
[82] Ibid, ss 76, 86B–86E, 87, and 88. [83] Ibid, s 60. [84] Ibid, s 105.

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loan agreement and supporting mortgage is regulated: in particular, the borrower must be supplied with a copy of the mortgage and given a cooling-off period of not less than seven days in which to consider his or her position before he or she can be asked to execute the mortgage, unless the mortgage is to secure bridging finance or a loan for the purchase of land.[85]

The consequence of a failure to provide the requisite information, or to comply with the rules governing the form and execution of this documentation, is that the agreement and mortgage are deemed incorrectly executed, and cannot be enforced except by order of the court.[86] The court is given a wide discretion, in the light of the prejudice caused to the borrower and the culpability of the lender, whether or not to enforce the agreement or mortgage, and, if enforcement is ordered, to impose conditions and amend or vary the terms of the agreement or mortgage.[87] If any order is refused the security becomes invalid.[88]

A lender also cannot enforce a compliant mortgage, save by court order[89] and not before notice of default has been given.[90] Where the default is a failure to pay the sums due under the mortgage, the lender must give notice of those arrears.[91] The lender also has no right to charge interest or any default sum until the requisite notices have been given.[92]

The CCA 2006 has also opened up the FSO complaints procedure to borrowers in dispute with their lenders under a mortgage regulated by the CCA 1974.[93]

2.2.3 The unfair credit relationship

Sections 137–140 of the CCA 1974 empowered the court to reopen consumer credit agreements where they found that the payment terms were 'grossly exorbitant', or where the agreement '*otherwise grossly contravene*[d] *ordinary principles of fair dealing*'. These tests were notoriously difficult to satisfy[94] and the court's interpretation of them was criticized in the government's White Paper as being unduly restrictive. It came as no surprise, therefore, that ss 137–140 have been repealed by the CCA 2006, and new provisions enacted in their place that are far wider in their approach. The revised provisions look to the unfairness of the relationship between the creditor and debtor and allow the court to consider not only the terms of the agreement, but also the lender's behaviour and practices throughout the term of the mortgage. The appropriate time to consider that question is, thus, the time of the trial or the time the relationship came to an end. It is not the date of the agreement.[95]

[85] Ibid, ss 58 and 61. See also ss 62, 64, 67, and 68, in relation to the execution of the credit agreement.

[86] Ibid, ss 65, 92, 105, and 126. See also OFT 1272 (October 2010).

[87] Ibid, ss 127, 135, and 136. See for instance *London North Securities Ltd v Meadows* [2005] EWCA Civ 956; *Wilson v Hurstanger Ltd* [2007] EWCA Civ 299; *McGuffick v Royal Bank of Scotland* [2009] EWHC 2386; *Carey v HSBC Plc* [2009] EWHC 3417; *Phoenix Recoveries (UK) Ltd v Kotecha* [2011] EWCA Civ 105.

[88] Ibid, ss 106, 113(3)c but see the saving for certain transferees of registered charges in s 177.

[89] Ibid, s 126. [90] Ibid, s 87.

[91] Ibid, ss 88B or 88C, and 86D(3). [92] Ibid, s 86D(4).

[93] Consumer Credit Act 2006, ss 59–61. See above.

[94] See *A Ketley Ltd v Scott* [1980] CCLR 37; *Davies v Direct Loans* [1986] 1 WLR 823; *Paragon Finance plc v Nash* [2002] 1 WLR 685.

[95] *Patel v Patel* [2009] EWHC 3264.

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Consumer Credit Act 1974 (as amended), s 140A

Unfair relationships between creditors and debtors

1. The court may make an order under section 140B in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following—

(a) any of the terms of the agreement or of any related agreement;

(b) the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement;

(c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).

2. In deciding whether to make a determination under this section the court shall have regard to all matters it thinks relevant (including matters relating to the creditor and matters relating to the debtor).

The redress that the court can order is also far-ranging and may extend to ordering the repayment of any sums paid by the debtor, the alteration of the terms of the mortgage, or the setting aside, either in whole or in part, of any duty imposed upon the borrower by the terms of the loan or mortgage.[96] The provisions, thus, have the potential to provide a powerful mechanism of judicial control of CCA mortgages.

However, the difficulty with the s 140A test is that there is little guidance on how it will operate. The government refused to include any guidelines in the legislation, preferring instead to give the courts a free rein. The OFT have issued guidance on how they perceive the test may operate when they seek to take enforcement action as a 'consumer champion' under Part 8 of the Enterprise Act 2002.[97]

Brown suggests that some guidance may be obtained from the Unfair Terms in Consumer Contracts Regulations 1999 (which we consider in section 4.1.3 below) and she also suggests that unexpected costs—for example, default charges—or the taking advantage of a borrower's disadvantageous position, or irresponsible lending, could be particular targets.[98]

To date, guidance from case law is limited although they do underline the width of judicial discretion.

Harrison v Black Horse Ltd
[2011] EWCA Civ 1128

Tomlinson LJ

At [37]

Three points should be noted at the outset. First, it is the relationship between the parties which must be determined to be unfair, not their agreement, although it is envisaged that the

[96] Consumer Credit Act 1974 (as amended), s 140B(1).

[97] OFT 859 Rev (May 2008 updated August 2011). The OFT have powers under Part 8 of the Enterprise Act 2002 to take enforcement action as a 'consumer champion' where they believe market practice to be detrimental to consumers.

[98] Brown, 'The Consumer Credit Act 2006: Real Additional Mortgagor Protection?' [2007] Conv 316,

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terms of the agreement may themselves give rise to an unfair relationship. Second, although s.140A is directed at determining unfairness to the debtor, in reaching that determination the court must have regard to matters relating to the creditor as well as matters relating to the debtor. Third, unlike provisions such as the Unfair Contract Terms Act 1977, which offers in Schedule 2 "Guidelines for Application of Reasonableness Test" or The Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999 No 2083), Schedule 2 of which is an "Indicative and Non-Exhaustive List of Terms which may be regarded as unfair", s.140A of the Act offers no guidance in respect of factors which either may or must be regarded as rendering a relationship unfair to the debtor.

The mis-selling of Payment Protection Insurance[99] has resulted in a number of cases.[100] An important theme that emerges from these cases is the significance the courts attach to statutory standards and other regulatory guidance. For instance, early cases took a dim view of lenders who took an undisclosed commission on the sale but the Court of Appeal in *Harrison v Black Horse Ltd* looked to regulatory guidance to dismiss suggestions that an undisclosed commission of 87 per cent of the insurance premium led to an unfair relationship.

Tomlinson LJ

At [58]

[. . .] the commission here is on any view quite startling and there will be many who regard it as unacceptable conduct on the part of lending institutions to have profited in this way. I struggle however to spell out of the mere size of the undisclosed commission an unfairness in the relationship between lender and borrower. Moreover the touchstone must in my view be the standard imposed by the regulatory authorities pursuant to their statutory duties, not resort to a visceral instinct that the relevant conduct is beyond the Pale. In that regard it is clear that the ICOB regime after due consultation and consideration does not require the disclosure of the receipt of commission. It would be an anomalous result if a lender was obliged to disclose receipt of a commission in order to escape a finding of unfairness under s.140A of the Act but yet not obliged to disclose it pursuant to the statutorily imposed regulatory framework under which it operates.

The main problems associated with the mis-selling of payment protection insurance have since been addressed by the regulatory authorities with lenders being required to pay out millions in compensation.[101]

[99] This insurance purports to cover the risk of non-payment of unsecured loans and also mortgages (MPPI) if the borrower suffers a loss of income from ill-health or unemployment. It was commonly sold by an insurer associated with the lender at the same time as the loan often by the payment of a single substantial premium.

[100] See for example *MBNA Europe Ltd v Thorius* [2010] ECC 8, *Wollerton v Black Horse Ltd* unreported 26th March 2010 *Yates v Nemo Personal Finance* unreported 14 May 2010, *Black Horse Ltd v Speak* [2010] EWHC 1866 but see *Harrison v Black Horse Ltd* [2011] EWCA Civ 1128. See also *Patel v Patel* [2009] EWHC 3264 and *Barons Finance Ltd v Olubisi* unreported 26 April 2010 for other instances where the courts have found an unfair relationship.

[101] See Competition Commissions Market Investigation into Payment Protection Insurance (January 2009) which led to certain policies being prohibited and the FSA's Policy Statement 10/12 (July 2010) on handling mis-selling complaints.

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3 CREATION OF THE MORTGAGE

Freedom of contract is a fundamental principle governing loan contracts as much as any other contract. We will see, in the next section, the legal controls over the parties' freedom to agree the substantive content of their loan terms and any mortgage taken to secure repayment of that loan. In this section, we are concerned with the process by which those terms are agreed. The focus here is with the quality of the parties' consent to contractual terms: in particular, the borrower's ability to enter freely into the loan without the lender abusing a dominant position.

We will concentrate in section 3.3 on the role that the doctrine of undue influence has played in collateral mortgages of the family home to secure a business loan. There are, however, other factors that can affect the procedural fairness of a loan, which we will briefly survey in section 3.1, before considering the conceptual basis that underlies these controls in section 3.2.

3.1 FACTORS GOVERNING PROCEDURAL FAIRNESS

The principal factors that may affect the procedural fairness of a mortgage will be familiar to any student of contract law and thus it is proposed to outline their essential features only briefly. The factors are:

- *non est factum*;
- duress;
- undue influence;
- misrepresentation;
- unconscionable bargain.

Non est factum and duress find their roots in the common law, and, accordingly, render the contract void from the outset. Undue influence and unconscionable bargain are equitable doctrines that entitle the wronged party to elect to rescind the transaction. The court may also award equitable compensation or set aside a transaction on terms where full restitution is not possible, because, for example, some benefit has been received by the victim. The remedies for misrepresentation will depend upon the intention with which the misrepresentation is formulated, and may result in a claim to rescind the transaction or to damages, either in the tort of deceit, where the misrepresentation is fraudulent, or in negligence or under statute, where the misrepresentation is negligent or innocent.

3.1.1 *Non est factum*

Where a party has made a fundamental mistake as to the character and effect of the obligations imposed by the mortgage, he or she may plead *non est factum*, provided that the mistake was no fault of his or her own.[102] The doctrine does not require any proof of fraud or wrongdoing, because its basis lies in the absence of the victim's consent. It was originally applied where a party could not read, because he or she was blind or illiterate, but has since been extended to wider circumstances in which a party's lack of comprehension is due to

[102] See *Saunders v Anglia Building Society*, sub nom *Gallie v Lee* [1971] AC 1004.

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other reasons (e.g. age, illness, limited education or understanding). Nevertheless, the doctrine has very limited application, because the victim must prove that he or she took due care in understanding the nature and effect of the mortgage, for example by asking for an explanation of its effect. A failure to read the mortgage is plainly insufficient.

3.1.2 Duress

A party may claim duress where he or she has been coerced or pressurized into a transaction. Originally, the coercion had to take the form of physical threats to the victim[103] or to his or her property,[104] but the doctrine has been expanded to admit more subtle means of pressure, including the illegitimate use of economic pressure: for example, threats to breach a contractual obligation.[105] The difficulty is to distinguish the use of sharp, but legitimate, negotiating tactics in the cut and thrust of commercial life from the illegitimate threats that may constitute economic duress.[106] Again, the rationale for intervention on the grounds of duress is that the victim has not freely consented to the transaction.

The Universe Sentinel
[1983] 1 AC 366, HL

Lord Scarman

At 400

There must be pressure, the practical effect of which is compulsion or absence of choice. Compulsion is variously described in the authorities as coercion or the vitiation of consent. The classic case of duress is, however, not the lack of will to submit but the victim's intentional submission arising from the realisation that there is no other practical choice open to him.

3.1.3 Undue influence

A comprehensive definition of undue influence is elusive.[107] Lord Clyde observed in *Royal Bank of Scotland v Etridge*[108] that '[i]*t is something which can be more easily recognised when found than exhaustively analysed in the abstract*'. At its core is the use of improper pressure or influence, which effectively deprives a party of his or her free and independent will. The victim may perfectly understand his or her actions, but, nevertheless, his or her judgment may have been overborne by the improper influence of another. In *Daniel v Drew*[109] Ward LJ gave the following guidance:

[103] *Barton v Armstrong* [1976] AC 104. [104] *Astley v Reynolds* (1731) 2 Str 915.

[105] See *Pao On v Lau Yiu Long* [1980] AC 614; *DSDN Subsea Ltd v Petroleum Geo-services ASA* [2000] BLR 530; *Huyton SA v Peter Cremer & Co* [1999] CLC 230; or, in the context of a mortgage, *Jones v Morgan* [2001] EWCA Civ 995.

[106] Economic duress is distinguishable from other forms of duress in that: firstly, it renders the contract voidable not void; and secondly, to be actionable, the duress must be the main reason that the victim acted as he or she did.

[107] In *Allcard v Skinner* (1887) 36 Ch D 145, 183, Lindley LJ commented that '*no court had ever attempted to define undue influence*'.

[108] [2002] 2 AC 773, [92]. [109] [2005] EWCA Civ 507.

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Ward LJ

At [36]

[. . .] in all cases of undue influence the critical question is whether or not the persuasion or the advice, in other words the influence, has invaded the free volition of the donor to accept or reject the persuasion or advice or withstand the influence. The donor may be led but she must not be driven and her will must be the offspring of her own volition, not a record of someone else's. There is no undue influence unless the donor if she were free and informed could say "This is not my wish but I must do it".

Undue influence takes one of two broad forms: firstly, actual undue influence arises where overt acts exert improper pressure in a similar manner to duress, to which the concept has been compared; secondly, undue influence may be presumed to exist from the relationship between two parties, where one has used his or her dominant position to exploit the weaker party. Certain types of relationship are accepted, in themselves, as giving rise to a presumption of undue influence without any further evidence that the trust inherent in these relationships has been abused. These relationships include solicitor and client, doctor and patient, religious leader and follower, parent and child. This list is not exhaustive and a presumption of undue influence may also arise where trust and confidence is established in the context of a particular relationship.

Lord Nicholls in *Etridge* sought to pin down the nature of this relational form of undue influence.

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [10]–[11]

The law has long recognised the need to prevent abuse of influence in these "relationship" cases despite the absence of evidence of overt acts of persuasive conduct. The types of relationship, such as parent and child, in which this principle falls to be applied cannot be listed exhaustively. Relationships are infinitely various. Sir Guenter Treitel QC has rightly noted that the question is whether one party has reposed sufficient trust and confidence in the other, rather than whether the relationship between the parties belongs to a particular type: see Treitel, *The Law of Contract*, 10th ed (1999), pp 380–381. For example, the relation of banker and customer will not normally meet this criterion, but exceptionally it may: see *National Westminster Bank plc v Morgan* [1985] AC 686, 707–709.

Even this test is not comprehensive. The principle is not confined to cases of abuse of trust and confidence. It also includes, for instance, cases where a vulnerable person has been exploited. Indeed, there is no single touchstone for determining whether the principle is applicable. Several expressions have been used in an endeavour to encapsulate the essence: trust and confidence, reliance, dependence or vulnerability on the one hand and ascendancy, domination or control on the other. None of these descriptions is perfect. None is all embracing. Each has its proper place.

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As a result of this relationship of trust and confidence between the parties, the dominant party is said to owe a special duty to deal fairly with the other—a duty that has been described as 'fiduciary'.[110]

Actual undue influence is actionable as a legal wrong.[111] The relational form of undue influence may give rise, in the light of the nature of the transaction that is being impugned, to a factual presumption of undue influence, which shifts the burden of proof to the dominant party to demonstrate that he or she dealt fairly with the weaker party, who was thus able to exercise his or her own judgment.

3.1.4 Misrepresentation

It is not uncommon for a party to try to persuade another party to contract by misrepresenting the facts surrounding the transaction. For example, in *Barclays Bank plc v O'Brien*,[112] Mr O'Brien persuaded his wife to mortgage her interest in the family home to secure a loan made to his business by misrepresenting the amount of the debt that was secured by the mortgage. An actionable misrepresentation is a material misrepresentation of existing fact, rather than of opinion or future intention, which induces a party to enter into the contract. Misrepresentation is often linked with undue influence in the common scenario that occurred in *O'Brien*, which we will be examining in more detail in section 3.3 below. However, there are particular necessary distinctions to show that the misrepresentation caused the victim to enter into the impugned transaction, whereas proof of undue influence is by itself an equitable wrong upon which the transaction can be set aside. Proof that the victim would not have entered into the transaction if they had known the truth is not required.[113]

3.1.5 Unconsionable bargain

Equity will provide redress where one party has abused the strength of his or her relative position to impose unacceptable terms upon the other party, who is in a position of relative weakness or disadvantage. The doctrine seeks to protect the weak or disadvantaged from those who would use their superior position unscrupulously.

In the context of a security transaction, this principle may be established by proof that:

- the borrower is at a serious disadvantage because of some particular weakness or disability;
- the borrower has been unconscionably exploited by the lender because of that disadvantage; and
- a mortgage has resulted on terms that are oppressive.

The doctrine is based upon the relative strengths of the parties to the mortgage and the fact that the dominant party has acted reprehensibly in taking advantage of that imbalance. The weaker party must establish that he or she was in a position of special disadvantage vis-à-vis the dominant party, and that his or her vulnerability was evident to the dominant party, so that the court is able to infer that the resulting transaction was procured by the abuse of that superior position. The balance of proof then shifts to the dominant party to establish, if he

110 Ibid at [104], *per* Lord Hobhouse.
111 *CIBC v Pitt* [1994] 1 AC 200.
112 [1994] 1 AC 180. See also *Royal Bank of Scotland Plc v Chandra* [2011] EWCA Civ 192.
113 See for instance *Hewett v First Plus Financial Group Plc* [2010] 2 P&CR 22.

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or she can, that he or she did not take advantage of that superior position and that the resulting mortgage, although onerous, did not result from any abuse.[114] The relative positions of the parties, the conduct of their negotiations, the improper use of influence or power, and the lack of information or absence of real choice are all relevant factors. The focus is upon the procedural, rather than the substantive, nature of the transaction, although oppressive terms may provide evidence that demonstrates the unconscionability of the process.[115]

The Court of Appeal considered the operation of the doctrine in the following case.

Alec Lobb Garages Ltd v Total Oil (GB) Ltd
[1885] 1 WLR 173, CA

Lord Dhillon

At 182

The whole emphasis is on extortion, or undue advantage taken of weakness, an unconscientious use of the power arising out of the inequality of the parties' circumstances, and on unconscientious use of power which the Court might in certain circumstances be entitled to infer from a particular—and in these days notorious—relationship unless the contract is proved to have been in fact fair, just and reasonable. Nothing leads me to suppose that the course of the development of the law over the last 100 years has been such that the emphasis on unconscionable conduct or unconscientious use of power has gone and relief will now be granted in equity in a case such as the present if there has been unequal bargaining power, even if the stronger has not used his strength unconscionably. I agree with the judgment of Browne-Wilkinson J. in *Multiservice Bookbinding Ltd. v. Marden* (1979) Ch. 84 which sets out that to establish that a term is unfair and unconscionable it is not enough to show that it is, objectively, unreasonable [...] Inequality of bargaining power must anyhow be a relative concept. It is seldom in any negotiation that the bargaining powers of the parties are absolutely equal. Any individual wanting to borrow money from a bank, building society or other financial institution in order to pay his liabilities or buy some property he urgently wants to acquire will have virtually no bargaining power; he will have to take or leave the terms offered to him. [...]

The Courts would only interfere in exceptional cases where as a matter of common fairness it was not right that the strong should be allowed to push the weak to the wall. The concepts of unconscionable conduct and of the exercise by the stronger of coercive power are thus brought in [...]

There are close links between relational undue influence and unconscionable bargains, and the same facts can give rise to an action based upon both doctrines. Indeed, some have argued that undue influence should be subsumed within a wider doctrine of unconscionability.[116] The English courts have preferred the undue influence route, but in other jurisdictions, the courts have applied unconscionable bargains. For example, in the Australian case of *Commonwealth Bank of Australia Ltd v Amadio*,[117] the doctrine was employed to set aside a mortgage granted by elderly Italian immigrants, with little command of English or experience of business, to secure a loan to their son's business. They believed that the business was flourishing: a belief based upon their son's misrepresentations and the bank's practice of dishonouring only some of the son's cheques to create an appearance of solvency. They also

[114] *Louth v Diprose* (1992) 175 CLR 621.
[115] *Hart v O'Connor* [1985] AC 1000, 1018.
[116] Capper (1998) 14 LQR 479.
[117] (1983) 151 CLR 447.

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believed that their liability was limited and they received no independent advice to cast a more realistic light on the transaction. In England, these facts would produce a clear claim of undue influence, but the case was pleaded and decided by the High Court of Australia on the grounds of unconscionable bargain—although the High Court criticized the pleadings and expressed a hope that such cases would, in future, be approached from the perspective of undue influence.[118]

There remain distinctions between undue influence and unconscionable bargains. Undue influence focuses upon the quality of consent of the weaker party, which is called into question by the nature of the relationship between the parties, whereas unconscionable bargain concentrates its attention upon the conduct of the dominant party. It is the exploitation of the relative weakness of one party, which is derived from some social or transactional disability, which merits the court's intervention.

3.2 THE CONCEPTUAL UNDERPINNINGS

There has been considerable debate surrounding the conceptual basis of these various vitiating factors: in particular, duress, undue influence, and unconscionable bargains. The main features of this debate are twofold: firstly, whether they are claimant-based, looking to the impaired consent of the victim, or defendant-based, looking to the exploitative nature of the defendant's conduct; secondly, there have been growing calls to assimilate the three grounds by looking to the underlying unconscionability of the defendant's use of their relative power.

Birks and Chin[119] have advocated a claimant-sided approach to undue influence that leads to a distinction between undue influence and unconscionable bargains. Undue influence looks to the vulnerability of the claimant's consent as a result of his or her dependence on the defendant, whilst unconscionable bargains is concerned with the defendant's exploitation of the claimant's weakness. We have already noted that, despite the obviously reprehensible conduct of duress and actual undue influence, the traditional conceptual foundations of these doctrines have been found in the suspect nature of the victim's apparent consent. Birks and Chin point out that presumed undue influence does not depend upon any conscious wrongdoing on behalf of the defendant, and that the presumption of influence may be rebutted by proof that the claimant did exercise his or her free and independent will.

Others have rejected this approach and have refocused the spotlight on the exploitative nature of the defendant's behaviour, thus drawing closer parallels with both duress and unconscionable bargains, which have resulted in calls for the assimilation of the three doctrines.[120] The common features of the doctrines have been identified as relational inequality (e.g. of bargaining power), transactional imbalance, and the defendant's unconscionable conduct, which, in the case of presumed undue influence, may be more passively imposed

[118] See ibid, at 464, *per* Mason J.

[119] Birks and Chin, 'On the Nature of Undue Influence' in *Good Faith and Fault in Contract Law* (eds Beatson and Friedman, 1995, ch 3). See also Birks, 'Undue Influence as Wrongful Exploitation' (2004) 120 LQR 34.

[120] Bigwood, 'Undue Influence: Impaired Consent or Wicked Exploitation' (1996) 16 OJLS 503; Chen-Wishart, 'The *O'Brien* Principle and Substantive Unfairness' (1997) 56 CLJ 60; Chen-Wishart, 'Undue Influence: Beyond Impaired Consent and Wrongdoing Towards a Relational Analysis' in *Mapping the Law* (eds Burrows and Rogers, 2006), ch 11; Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479; Deveney and Chandler, 'Unconscionability and the Taxonomy of Undue Influence' [2007] JBL 541.

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than overtly or intentionally exerted.[121] These features do not necessarily contribute equally, but rather form an evidentiary mix that combine in different measure according to the circumstances of the particular case.

Intriguing though these arguments are, the more practical policy imperatives that underpin the exercise of 'state-assisted rescission' of apparently binding obligations should not be overlooked.[122] This policy is particularly evident in the series of decisions on undue influence that have occupied the House of Lords, which seeks to balance the protection of the vulnerable surety against modern business lending practices. The House of Lords first expressed its opinion in *Barclays Bank plc v O'Brien*,[123] but some years later, developed and refined its views in *Royal Bank of Scotland v Etridge*.[124] These two decisions will dominate our consideration of the operation of undue influence in mortgage transactions.

3.3 UNDUE INFLUENCE AND MORTGAGES

Undue influence has been raised as a defence to enforcement proceedings where a collateral mortgage has been granted over the family home to secure a loan made for the benefit of the husband's business. The loan is made to the husband, as borrower, but the wife's participation to create the mortgage is required where she is a legal or beneficial joint owner of the family home. The danger is that the wife's consent to the mortgage is questionable, because, in the husband's desire to finance his business, he may have misrepresented the amount of the secured liability or the risks of enforcement, or have unduly influenced his wife to mortgage her interest.

The trend was noted in *O'Brien*.[125]

Barclays Bank plc v O'Brien
[1994] 1 AC 180, HL

Lord Browne-Wilkinson

At 188

The large number of cases of this type coming before the courts in recent years reflects the rapid changes in social attitudes and the distribution of wealth which have recently occurred. Wealth is now more widely spread. Moreover a high proportion of privately owned wealth is invested in the matrimonial home. Because of the recognition by society of the equality of the sexes, the majority of matrimonial homes are now in the joint names of both spouses. Therefore in order to raise finance for the business enterprises of one or other of the spouses, the jointly owned home has become a main source of security. The provision of such security requires the consent of both spouses.

In parallel with these financial developments, society's recognition of the equality of the sexes has led to a rejection of the concept that the wife is subservient to the husband in the

[121] See Capper (1998) and Chen-Wishart (1997).

[122] Bigwood, 'Contracts by Unfair Advantage: From Exploitation to Transactional Neglect' (2005) 25 OJLS 65; Ferris; 'Why is the Law of Undue Influence So Hard to Understand and Apply?' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007).

[123] [1994] 1 AC 180. [124] [2002] 2 AC 773.

[125] See also *Royal Bank of Scotland v Etridge*, ibid at 800–1, *per* Lord Nicholls.

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management of the family's finances. A number of the authorities reflect an unwillingness in the court to perpetuate law based on this outmoded concept. Yet [. . .] although the concept of the ignorant wife leaving all financial decisions to the husband is outmoded, the practice does not yet coincide with the ideal. In a substantial proportion of marriages it is still the husband who has the business experience and the wife is willing to follow his advice without bringing a truly independent mind and will to bear on financial decisions. The number of recent cases in this field shows that in practice many wives are still subjected to, and yield to, undue influence by their husbands. Such wives can reasonably look to the law for some protection when their husbands have abused the trust and confidence reposed in them.

On the other hand, it is important to keep a sense of balance in approaching these cases. It is easy to allow sympathy for the wife who is threatened with the loss of her home at the suit of a rich bank to obscure an important public interest viz., the need to ensure that the wealth currently tied up in the matrimonial home does not become economically sterile. If the rights secured to wives by the law renders vulnerable loans granted on the security of matrimonial homes, institutions will be unwilling to accept such security, thereby reducing the flow of loan capital to business enterprises. It is therefore essential that a law designed to protect the vulnerable does not render the matrimonial home unacceptable as security to financial institutions.

The context is rather different from that commonly associated with undue influence where a donee has obtained a gift that the donor subsequently seeks to set aside, because his or her consent was obtained by undue influence. Here, it is the husband who, it is alleged, exerted undue influence to persuade his wife to grant a mortgage to the lender. There is no suggestion that the lender is guilty of undue influence, but, in *O'Brien*, the House of Lords decided that a lender who has actual or constructive notice of the risk of undue influence or misrepresentation by the husband will be bound by any right of the wife to set aside the mortgage against her interest in the home.

Barclays Bank plc v O'Brien
[1994] 1 AC 180, HL

Lord Browne-Wilkinson

At 191

But in surety cases the decisive question is whether the claimant wife can set aside the transaction, not against the wrongdoing husband, but against the creditor bank. Of course, if the wrongdoing husband is acting as agent for the creditor bank in obtaining the surety from the wife, the creditor will be fixed with the wrongdoing of its own agent and the surety contract can be set aside as against the creditor. Apart from this, if the creditor bank has notice, actual or constructive, of the undue influence exercised by the husband (and consequentially of the wife's equity to set aside the transaction) the creditor will take subject to that equity and the wife can set aside the transaction against the creditor (albeit a purchaser for value) as well as against the husband: see *Bainbrigge v. Browne* (1881) 18 Ch.D. 188 and *Bank of Credit and Commerce International S.A. v. Aboody* [1990] 1 Q.B. 923, 973. Similarly, in cases such as the present where the wife has been induced to enter into the transaction by the husband's misrepresentation, her equity to set aside the transaction will be enforceable against the creditor if either the husband was acting as the creditor's agent or the creditor had actual or constructive notice.

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It is unlikely that the husband is an agent of the lender and so it is the application of the concept of notice that has attracted the greatest attention. This application of notice must be contrasted with the doctrine of notice that we have considered in relation to the priority of proprietary interests in Chapter 13. Instead, what is in issue is the notice of a party to the mortgage (i.e. the lender) to the possibility that the wife's consent to the mortgage may have been obtained by improper means.

The distinction was highlighted in *Royal Bank of Scotland v Etridge*.[126]

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Scott

At [144]

The doctrine of notice is a doctrine that relates primarily and traditionally to the priority of competing property rights. [. . .] Banks and other lenders who take charges from surety wives are certainly purchasers of property rights. But they acquire their rights by grant from the surety wives themselves. The issue between the banks and the surety wives is not one of priority of competing interests. The issue is whether or not the surety wife is to be bound by her apparent consent to the grant of the security to the bank. If contractual consent has been procured by undue influence or misrepresentation for which a party to the contract is responsible, the other party, the victim, is entitled, subject to the usual defences of change of position, affirmation, delay etc, to avoid the contract. But the case is much more difficult if the undue influence has been exerted or the misrepresentation has been made not by the party with whom the victim has contracted, but by a third party. It is, in general, the objective manifestation of contractual consent that is critical. Deficiencies in the quality of consent to a contract by a contracting party, brought about by undue influence or misrepresentation by a third party, do not, in general, allow the victim to avoid the contract. But if the other contracting party had had actual knowledge of the undue influence or misrepresentation the victim would not, in my opinion, be held to the contract (see *Commission for the New Towns v Cooper (Great Britain) Ltd* [1995] Ch 259, 277–280 and *Banco Exterior Internacional SA v Thomas* [1997] 1 WLR 221, 229). But what if there had been no actual knowledge of the third party's undue influence or misrepresentation but merely knowledge of facts or circumstances that, if investigated, might have led to actual knowledge? In what circumstances does the law expect a contracting party to inquire into the reasons why the other party is entering into the contract or to go behind the other party's apparent agreement, objectively ascertained, to enter into the contract? These are the questions that Lord Browne-Wilkinson had to answer in *O'Brien*. They are contractual questions, not questions relating to competing property interests [. . .]

At [146]–[148]

In particular, it must be recognised that in the "bank v surety wife" cases the constructive notice that is sought to be attributed to the bank is not constructive notice of any pre-existing prior right or prior equity of the wife. The husband's impropriety, whether undue influence or misrepresentation, in procuring his wife to enter into a suretyship transaction with the bank would not entitle her to set it aside unless the bank had had notice of the impropriety. It is notice of the husband's impropriety that the bank must have, not notice of any prior rights of the wife. It is the notice that the bank has of the impropriety that creates the wife's right to set aside the transaction. The wife does not have any prior right or prior equity.

126 See also [38]–[43], *per* Lord Nicholls.

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In a case where the financial arrangements with the bank had been negotiated by the husband, no part in the negotiations having been played by the wife, and where the arrangements required the wife to become surety for her husband's debts, the bank would, or should, have been aware of the vulnerability of the wife and of the risk that her agreement might be procured by undue influence or misrepresentation by the husband. In these circumstances the bank would be "put on inquiry", as Lord Browne-Wilkinson put it. But "on inquiry" about what? Not about the existence of undue influence, for how could any inquiry reasonably to be expected of a bank satisfy the bank that there was no undue influence? "On inquiry", in my opinion, as to whether the wife understood the nature and effect of the transaction she was entering into. This is not an "inquiry" in the traditional constructive notice sense. The bank would not have to carry out any investigation or to ask any questions about the reasons why the wife was agreeing to the transaction or about her relationship with her husband. The bank would not, unless it had notice of additional facts pointing to undue influence or misrepresentation, be on notice that undue influence or misrepresentation was to be presumed. It would simply be on notice of a risk of some such impropriety. What Lord Browne-Wilkinson had in mind was that the bank should be expected to take reasonable steps to satisfy itself that she understood the transaction she was entering into. If the bank did so, no longer could constructive notice of any impropriety by the husband in procuring his wife's consent be imputed to it. The original constructive notice would have been shed. If, on the other hand, a bank with notice of the risk of some such impropriety, failed to take the requisite reasonable steps, then, if it transpired that the wife's consent had been procured by the husband's undue influence or misrepresentation, constructive knowledge that that was so would be imputed to the bank and the wife would have the same remedies as she would have had if the bank had had actual knowledge of the impropriety.

Under Lord Browne-Wilkinson's scheme for the protection of vulnerable wives it is the bank's perception of the risk that the wife's consent may have been procured by the husband's misrepresentation or undue influence that is central. The risk must be viewed through the eyes of the bank. Some degree of risk can, usually, never be wholly eliminated. But it can be reduced to a point at which it becomes reasonable for the bank to rely on the apparent consent of the wife to enter into the transaction and to take no further steps to satisfy itself that she understood the transaction she was entering into.

To avoid notice of the risk that the wife's consent to the mortgage has not been freely given, the lender must take reasonable and adequate steps to satisfy itself that the wife understood the nature of the mortgage into which she was entering, and that she was doing so of her independent will.

Three distinct stages were identified in *Etridge* to determine whether or not a mortgage may be set aside on the ground of undue influence.

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Hobhouse

At 819

It can be expressed by answering three questions: (1) Has the wife proved what is necessary for the court to be satisfied that the transaction was affected by the undue influence of the husband? (2) Was the lender put on inquiry? (3) If so, did the lender take reasonable

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steps to satisfy itself that there was no undue influence? It will be appreciated that unless the first question is answered in favour of the wife neither of the later questions arise. The wife has no defence and is liable. It will likewise be appreciated that the second and third questions arise from the fact that the wife is seeking to use the undue influence of her husband as a defence against the lender and therefore has to show that the lender should be affected by the equity—that it is unconscionable that the lender should enforce the secured contractual right against her.

3.3.1 The first stage: proof of undue influence

The wife must prove that she was unduly influenced by her husband: if there is no undue influence, there is no basis upon which she can set aside the mortgage against her interest in the home. Undue influence may be established either by proof of facts that demonstrate actual undue influence (e.g. threats of physical violence or psychological pressure), which left the wife unable to exercise her own judgment, or by producing evidence that will enable the court to infer that the wife's entry into the mortgage was obtained by the undue influence that her husband was presumed to have exerted. It is for the wife to prove either actual or presumed undue influence; upon establishing facts that raise a presumption of undue influence, however, the burden of proof shifts to the dominant party (i.e. the husband or the bank) to demonstrate that, in fact, the wife's participation was an exercise of her independent will.

These alternative ways of proving undue influence were characterized in *BCCI v Aboody*[127] as 'Class 1 actual undue influence' and 'Class 2 presumed undue influence', which could be inferred either through proof of a Class 2A relationship, when certain limited types of relationship (see above) were themselves sufficient to found the presumption, or in Class 2B, upon proof that the particular relationship was one of trust and confidence. Although the House of Lords in *O'Brien* adopted this classification, in *Etridge*, the House observed that the classification had led to an overly formulaic approach that had obscured the evidentiary role of presumed undue influence. Instead, the Lords reiterated that proof of undue influence was a question of fact, and articulated in more detailed and stringent terms when undue influence would be proved.[128]

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [13]–[14]

Whether a transaction was brought about by the exercise of undue influence is a question of fact. Here, as elsewhere, the general principle is that he who asserts a wrong has been committed must prove it. The burden of proving an allegation of undue influence rests upon the person who claims to have been wronged. This is the general rule. The evidence required to discharge the burden of proof depends on the nature of the alleged undue influence, the

[127] [1991] 1 QB 923.

[128] See also [2002] 2 AC 773, [882], *per* Lord Hobhouse.

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personality of the parties, their relationship, the extent to which the transaction cannot readily be accounted for by the ordinary motives of ordinary persons in that relationship, and all the circumstances of the case.

Proof that the complainant placed trust and confidence in the other party in relation to the management of the complainant's financial affairs, coupled with a transaction which calls for explanation, will normally be sufficient, failing satisfactory evidence to the contrary, to discharge the burden of proof. On proof of these two matters the stage is set for the court to infer that, in the absence of a satisfactory explanation, the transaction can only have been procured by undue influence. In other words, proof of these two facts is prima facie evidence that the defendant abused the influence he acquired in the parties' relationship. He preferred his own interests. He did not behave fairly to the other. So the evidential burden then shifts to him. It is for him to produce evidence to counter the inference which otherwise should be drawn [. . .]

At [16]–[19]

Generations of equity lawyers have conventionally described this situation as one in which a presumption of undue influence arises. This use of the term "presumption" is descriptive of a shift in the evidential onus on a question of fact. When a plaintiff succeeds by this route he does so because he has succeeded in establishing a case of undue influence. The court has drawn appropriate inferences of fact upon a balanced consideration of the whole of the evidence at the end of a trial in which the burden of proof rested upon the plaintiff. The use, in the course of the trial, of the forensic tool of a shift in the evidential burden of proof should not be permitted to obscure the overall position. These cases are the equitable counterpart of common law cases where the principle of res ipsa loquitur is invoked. There is a rebuttable evidential presumption of undue influence.

The availability of this forensic tool in cases founded on abuse of influence arising from the parties' relationship has led to this type of case sometimes being labelled "presumed undue influence". This is by way of contrast with cases involving actual pressure or the like, which are labelled "actual undue influence": [. . .]

The evidential presumption discussed above is to be distinguished sharply from a different form of presumption which arises in some cases. The law has adopted a sternly protective attitude towards certain types of relationship in which one party acquires influence over another who is vulnerable and dependent and where, moreover, substantial gifts by the influenced or vulnerable person are not normally to be expected. Examples of relationships within this special class are parent and child, guardian and ward, trustee and beneficiary, solicitor and client, and medical adviser and patient. In these cases the law presumes, irrebuttably, that one party had influence over the other. The complainant need not prove he actually reposed trust and confidence in the other party. It is sufficient for him to prove the existence of the type of relationship.

It is now well established that husband and wife is not one of the relationships to which this latter principle applies.

Thus, a wife wishing to raise a presumption of undue influence will need to provide evidence to the court: firstly, that the relationship she enjoyed with her husband in respect of financial decisions was one in which she reposed trust and confidence, rather than exercised her own judgment; and secondly, that the nature of the mortgage itself leads to an inference that there was a risk that her husband persuaded her to enter into the mortgage by questionable means. The burden of proof will then shift to establish that the wife did, in fact, give her consent freely.

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As we have already observed, a relationship of trust and confidence is easier to recognize than to define. Lord Scott in *Etridge* went so far as to suggest that, in the normal course, a husband and wife's relationship was one of trust and confidence, and what was required was proof that this inherent trust and confidence had been abused.

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Scott

At [159]–[160]

For my part, I would assume in every case in which a wife and husband are living together that there is a reciprocal trust and confidence between them. In the fairly common circumstance that the financial and business decisions of the family are primarily taken by the husband, I would assume that the wife would have trust and confidence in his ability to do so and would support his decisions. I would not expect evidence to be necessary to establish the existence of that trust and confidence. I would expect evidence to be necessary to demonstrate its absence. In cases where experience, probably bitter, had led a wife to doubt the wisdom of her husband's financial or business decisions, I still would not regard her willingness to support those decisions with her own assets as an indication that he had exerted undue influence over her to persuade her to do so. Rather I would regard her support as a natural and admirable consequence of the relationship of a mutually loyal married couple. The proposition that if a wife, who generally reposes trust and confidence in her husband, agrees to become surety to support his debts or his business enterprises a presumption of undue influence arises is one that I am unable to accept. To regard the husband in such a case as a presumed "wrongdoer" does not seem to me consistent with the relationship of trust and confidence that is a part of every healthy marriage.

There are, of course, cases where a husband does abuse that trust and confidence. He may do so by expressions of quite unjustified over-optimistic enthusiasm about the prospects of success of his business enterprises. He may do so by positive misrepresentation of his business intentions, or of the nature of the security he is asking his wife to grant his creditors, or of some other material matter. He may do so by subjecting her to excessive pressure, emotional blackmail or bullying in order to persuade her to sign. But none of these things should, in my opinion, be presumed merely from the fact of the relationship of general trust and confidence. More is needed before the stage is reached at which, in the absence of any other evidence, an inference of undue influence can properly be drawn or a presumption of the existence of undue influence can be said to arise.

Relevant factors in determining the strength of a spousal relationship of trust and confidence include: the relative ages, education, and experience of the husband and wife; as well as the nature of their relationship, including its length; their respective characters; and the roles that they have assumed in their joint lives. Cultural factors may also have a part of play where particular religious or social norms dictate that a wife plays a subservient role in financial matters.[129] Feminist legal scholars have highlighted the gender imbalance inherent in the spousal relationship and have dubbed the phenomenon 'sexual transmitted debt'.[130]

[129] See *Barclays Bank v Coleman* [2002] 2 AC 773.
[130] See Kaye, 'Equity's Treatment of Sexually Transmitted Debt' (1997) 5 Feminist LS 35.

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The House of Lords have underlined that a relationship of trust and confidence may exist between cohabiting heterosexual and homosexual couples, as well as between husband and wife. Nevertheless, trust and confidence is not dependent on a sexual relationship, but may arise in other close relationships—for example, between other family members[131]—and may even exceptionally exist in relationships that are apparently commercial—for example, that between employer and employee.[132]

Proof of a relationship of trust and confidence is not in itself sufficient; the wife must also prove that her entry into the mortgage is not readily explicable as an exercise of her independent will. In *National Westminster Bank v Morgan*,[133] the House of Lords had initially called for proof of a transaction that was 'manifestly disadvantageous' to the wife because, for example, she did not benefit from the loan. The courts often inclined to the view that a collateral mortgage over the family home to secure a loan to the husband's business was manifestly disadvantageous, in that the wife was placing the residential security of the home at risk for no direct financial benefit. A flood of undue influence cases followed. The House of Lords in *Etridge* abandoned the manifest disadvantage label and reverted instead to the test laid down in *Allcard v Skinner*,[134] which looks to whether or not the transaction is explicable by the relationship of the parties or calls for some further explanation.[135] The House also observed that a collateral mortgage of the family home to secure a husband's business debts will often be explicable by the nature of the parties' relationship and will not require any further explanation.[136]

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [30]–[33] and [36]

[. . .] I do not think that, in the ordinary course, a guarantee of the character I have mentioned is to be regarded as a transaction which, failing proof to the contrary, is explicable only on the basis that it has been procured by the exercise of undue influence by the husband. Wives frequently enter into such transactions. There are good and sufficient reasons why they are willing to do so, despite the risks involved for them and their families. They may be enthusiastic. They may not. They may be less optimistic than their husbands about the prospects of the husbands' businesses. They may be anxious, perhaps exceedingly so. But this is a far cry from saying that such transactions as a class are to be regarded as prima facie evidence of the exercise of undue influence by husbands.

I have emphasised the phrase "in the ordinary course". There will be cases where a wife's signature of a guarantee or a charge of her share in the matrimonial home does call for explanation.

131 See *Abbey National Bank plc v Stringer* [2006] EWCA Civ 338.
132 See *Credit Lyonnais v Burch* [1997] 1 All ER 144.
133 [1985] AC 686. 134 (1885) 26 Ch D 145.
135 See *Chater v Mortgage Services Agency Number Two Ltd* [2003] EWCA Civ 490; *National Commercial Bank (Jamaica) Ltd v Hew* [2003] UKPC 51; *Maklin v Dowsett* [2004] EWCA Civ 904; *Turkey v Awadh* [2005] 2 FCR 7; *Abbey National v Stringer* [2006] EWCA Civ 338.
136 Lord Hobhouse suggested that a mortgage to secure the unlimited debts of the husband's business called for an explanation: [2002] 2 AC 733, [112].

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> I add a cautionary note [...] It concerns the general approach to be adopted by a court when considering whether a wife's guarantee of her husband's bank overdraft was procured by her husband's undue influence. Undue influence has a connotation of impropriety. In the eye of the law, undue influence means that influence has been misused. Statements or conduct by a husband which do not pass beyond the bounds of what may be expected of a reasonable husband in the circumstances should not, without more, be castigated as undue influence. Similarly, when a husband is forecasting the future of his business, and expressing his hopes or fears, a degree of hyperbole may be only natural. Courts should not too readily treat such exaggerations as misstatements.
>
> Inaccurate explanations of a proposed transaction are a different matter. So are cases where a husband, in whom a wife has reposed trust and confidence for the management of their financial affairs, prefers his interests to hers and makes a choice for both of them on that footing. Such a husband abuses the influence he has. He fails to discharge the obligation of candour and fairness he owes a wife who is looking to him to make the major financial decisions [...]
>
> At the same time, the high degree of trust and confidence and emotional interdependence which normally characterises a marriage relationship provides scope for abuse. One party may take advantage of the other's vulnerability. Unhappily, such abuse does occur. Further, it is all too easy for a husband, anxious or even desperate for bank finance, to misstate the position in some particular or to mislead the wife, wittingly or unwittingly, in some other way. The law would be seriously defective if it did not recognise these realities.

In the latter part of the above extract Lord Nicholls refers to the need for 'candour and fairness' in a relationship of trust and confidence and the connotations of impropriety upon which undue influence is founded. He makes these observations in the context of the (mis-) statements that may be made to encourage the wife to act as surety but candour and fairness may equally call for openness by the husband, which requires disclosure of facts that would affect the wife's decision. For instance, in *Hewett v First Plus Financial Group Plc*[137] a husband, who hid the fact that he was having an affair when persuading his wife to mortgage their family home to avoid his bankruptcy, was found to have unduly influenced his wife.

A presumption of undue influence may be rebutted by proof (provided by the husband or lender) that the wife did, in fact, enter into the mortgage of her own free and independent will. The most usual way of demonstrating that this is so, is to show that the wife decided to enter into the mortgage after receiving independent advice, thus breaking the influence that previously controlled her actions. The courts have been at pains to point out, however, that independent advice is no assurance that the presumption is rebutted; that is a question of fact, in the light of all of the circumstances.[138]

The House of Lords in *Etridge* provided guidance to solicitors when called upon to advise a wife.[139] The solicitors must be suitably qualified, both in terms of their professional capability to provide advice and their impartiality. There must be no conflict with the interests of their other clients: for example, the husband or the lender. The advice must be given in an environment that is free from the husband's influence and at a time before the transaction that provides sufficient opportunity for the wife to consider the import of the advice before she decides whether or not to proceed. The advice itself must not only explain the terms of

137 [2010] 2 P&CR 22. See also *Royal Bank of Scotland v Chandra* [2010] 1 Lloyds Rep 677.
138 *BCCI v Aboody* [1990] 1 QB 923, 971; *UBC Corporate Services Ltd v Williams* [2002] EWCA Civ 555.
139 [2002] 2 AC 733, [64]–[69], *per* Lord Nicholls, and [169]–[170], *per* Lord Scott.

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the mortgage, but must also explain the implications and consequences of the mortgage for the wife—in particular, that she could lose her home or become bankrupt if the loan is not repaid. The more difficult issue is the extent to which the solicitor should weigh and advise on the risks of enforcement, in the light of the wife's liabilities under the mortgage. The solicitor can make observations on the legal extent of these liabilities, but may not be qualified, or may not have sufficient information, to provide guidance on the commercial risks of the business generating the projected profit to meet those liabilities. What is clear is that the solicitor should press home that '*the wife has a choice. The decision is hers and hers alone*'.[140]

3.3.2 The second stage: notice of the bank

We have already observed that a lender, although not itself guilty of undue influence, may become subject to a wife's equity to set aside a mortgage entered into as result of the husband's actual or presumed undue influence, where it has notice of the risk that a wife may not have exercised her own independent judgment.

The House of Lords in *O'Brien* had set a test of notice that required proof of a relationship carrying a heightened risk of equitable wrong (whether of duress, undue influence, or misrepresentation) and a transaction that was disadvantageous to the weaker party—a test that tended to converge with that of presumed undue influence under *O'Brien*. In *Etridge*, however, the Lords clearly differentiated the two stages. Whilst they expressed proof of presumed undue influence in more stringent terms, they set a simple and relatively low-level threshold of notice, which would be straightforward for lenders to identify. The *Etridge* test provides that a lender should be put on notice whenever a wife stood as a surety for her husband's debts. The difficulty is that it is not always easy to identify whether it is the husband's business or a family business in which the wife is also interested.

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [48]–[49]

As to the type of transactions where a bank is put on inquiry, the case where a wife becomes surety for her husband's debts is, in this context, a straightforward case. The bank is put on inquiry. On the other side of the line is the case where money is being advanced, or has been advanced, to husband and wife jointly. In such a case the bank is not put on inquiry, unless the bank is aware the loan is being made for the husband's purposes, as distinct from their joint purposes. That was decided in *CIBC Mortgages plc v Pitt* [1994] 1 AC 200.

Less clear cut is the case where the wife becomes surety for the debts of a company whose shares are held by her and her husband. Her shareholding may be nominal, or she may have a minority shareholding or an equal shareholding with her husband. In my view the bank is put on inquiry in such cases, even when the wife is a director or secretary of the company. Such cases cannot be equated with joint loans. The shareholding interests, and the identity of the directors, are not a reliable guide to the identity of the persons who actually have the conduct of the company's business.

[140] Ibid, [65]. Solicitors were found negligent in *Burbank Securities Ltd v Wong* [2008] EWHC 552.

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The House of Lords in *Etridge* set a similar low threshold where there is a risk of presumed undue influence between other parties, who enjoy a relationship of trust and confidence, and who enter into a mortgage that calls for an explanation. In these circumstances, a bank is 'put on inquiry' of the risk of presumed undue influence whenever the relationship between the surety and the debtor is non-commercial.[141]

A bank will, thus, not be put on inquiry where the loan is to the husband and wife (or other parties) as joint borrowers unless the bank is aware that the loan is solely for the use of just one of the parties.[142] Where the loan is made to a sole borrower the lender will be put on inquiry if they were aware that the loan was for the benefit of another with whom the borrower enjoyed a relationship of trust and confidence.[143]

3.3.3 The third stage: the steps that the bank should take

Where the bank has notice of the risk that the surety's consent may have been procured by undue influence, it is required to '*take reasonable steps to bring home to the individual guarantor the risks he is running by standing as surety*'.[144] In both *O'Brien* and *Etridge*, the House of Lords was at pains to outline what those steps should be. In *O'Brien*, Lord Brown-Wilkinson suggested that the bank should arrange a private interview with the wife to explain to her those risks and advise her to take independent advice. But this practice did not find favour with lenders; they were reluctant to take direct responsibility for advising the wife; instead, they preferred to look to solicitors to shoulder that task. As a result, the House of Lords in *Etridge* reformulated the steps that a lender should take, emphasizing that the situation should be examined from the point of view of the lender. Those steps are not directed at '*discovering whether the wife has been wronged by her husband*', but are '*concerned to minimise the risk that such a wrong may have been committed*'.[145]

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [54]

The furthest a bank can be expected to go is to take reasonable steps to satisfy itself that the wife has had brought home to her, in a meaningful way, the practical implications of the proposed transaction. This does not wholly eliminate the risk of undue influence or misrepresentation. But it does mean that a wife enters into a transaction with her eyes open so far as the basic elements of the transaction are concerned

[. . .]

At [79]

I now return to the steps a bank should take when it has been put on inquiry and for its protection is looking to the fact that the wife has been advised independently by a solicitor.

141 Ibid, [87], *per* Lord Nicholls.

142 Ibid, [48] *per* Lord Nicholls. See also *CIBC v Pitt* [1994] 1 AC 200 and *Chater v Mortgage Services Agency Number Two Ltd* [2003] EWCA Civ 490.

143 See, e.g. *Burbank Securities Ltd v Wong* [2008] EWHC 552

144 156 *Royal Bank of Scotland v Etridge* [2002] 2 AC 773, [87], *per* Lord Nicholls.

145 Ibid, [41], *per* Lord Nicholls. See also [164]–[165], *per* Lord Scott.

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1. One of the unsatisfactory features in some of the cases is the late stage at which the wife first became involved in the transaction. In practice she had no opportunity to express a view on the identity of the solicitor who advised her. She did not even know that the purpose for which the solicitor was giving her advice was to enable him to send, on her behalf, the protective confirmation sought by the bank. Usually the solicitor acted for both husband and wife.

Since the bank is looking for its protection to legal advice given to the wife by a solicitor who, in this respect, is acting solely for her, I consider the bank should take steps to check directly with the wife the name of the solicitor she wishes to act for her. To this end, in future the bank should communicate directly with the wife, informing her that for its own protection it will require written confirmation from a solicitor, acting for her, to the effect that the solicitor has fully explained to her the nature of the documents and the practical implications they will have for her. She should be told that the purpose of this requirement is that thereafter she should not be able to dispute she is legally bound by the documents once she has signed them. She should be asked to nominate a solicitor whom she is willing to instruct to advise her, separately from her husband, and act for her in giving the necessary confirmation to the bank. She should be told that, if she wishes, the solicitor may be the same solicitor as is acting for her husband in the transaction. If a solicitor is already acting for the husband and the wife, she should be asked whether she would prefer that a different solicitor should act for her regarding the bank's requirement for confirmation from a solicitor.

The bank should not proceed with the transaction until it has received an appropriate response directly from the wife.

2. Representatives of the bank are likely to have a much better picture of the husband's financial affairs than the solicitor. If the bank is not willing to undertake the task of explanation itself, the bank must provide the solicitor with the financial information he needs for this purpose. Accordingly it should become routine practice for banks, if relying on confirmation from a solicitor for their protection, to send to the solicitor the necessary financial information. What is required must depend on the facts of the case. Ordinarily this will include information on the purpose for which the proposed new facility has been requested, the current amount of the husband's indebtedness, the amount of his current overdraft facility, and the amount and terms of any new facility. If the bank's request for security arose from a written application by the husband for a facility, a copy of the application should be sent to the solicitor. The bank will, of course, need first to obtain the consent of its customer to this circulation of confidential information. If this consent is not forthcoming the transaction will not be able to proceed.

3. Exceptionally there may be a case where the bank believes or suspects that the wife has been misled by her husband or is not entering into the transaction of her own free will. If such a case occurs the bank must inform the wife's solicitors of the facts giving rise to its belief or suspicion.

4. The bank should in every case obtain from the wife's solicitor a written confirmation to the effect mentioned above.

The focus of these steps is thus to ensure that the wife is legally represented and that the lender receives confirmation from the solicitor acting for her that she has received advice. [146]

[146] *Lloyds TSB Bank Plc v Holdgate* [2002] EWCA Civ 1543 [2003] HLR 25 *Bank of Scotland v Hill* [2002] EWCA Civ 1081.

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To ensure that the wife's solicitor is in a position to give meaningful advice, the lender must disclose relevant financial information and any information that gives rise to any particular suspicions that the wife may have been improperly influenced by her husband. Given that the situation is viewed from the position of the lender, the lender is not required to be privy to the advice that the wife actually receives; it merely needs to receive confirmation that she has received advice, even if that advice is inadequate. The wife's right of action in these circumstances is against her solicitor for his or her negligent advice; she cannot challenge the mortgage itself unless the lender actually learns that she did not received advice or that the advice was inadequate.[147]

A further difficult question is the independence of the wife's solicitor: can a solicitor who acts also for the bank and/or the husband provide adequate independent advice to the wife? Clearly, it is preferable that the wife receives advice from a solicitor who can take a wholly impartial view of the prudence of the mortgage, but to add the fees of another professional adviser may be unwarranted in a situation in which finances are already stretched. The House of Lords in *Etridge* addressed this issue in a pragmatic fashion by leaving it to the solicitor's professional judgment to decide if there was an unacceptable conflict of interest.

Royal Bank of Scotland v Etridge
[2002] 2 AC 773, HL

Lord Nicholls

At [74]

The advantages attendant upon the employment of a solicitor acting solely for the wife do not justify the additional expense this would involve for the husband. When accepting instructions to advise the wife the solicitor assumes responsibilities directly to her, both at law and professionally. These duties, and this is central to the reasoning on this point, are owed to the wife alone. In advising the wife the solicitor is acting for the wife alone. He is concerned only with her interests. I emphasise, therefore, that in every case the solicitor must consider carefully whether there is any conflict of duty or interest and, more widely, whether it would be in the best interests of the wife for him to accept instructions from her. If he decides to accept instructions, his assumption of legal and professional responsibilities to her ought, in the ordinary course of things, to provide sufficient assurance that he will give the requisite advice fully, carefully and conscientiously. Especially so, now that the nature of the advice called for has been clarified. If at any stage the solicitor becomes concerned that there is a real risk that other interests or duties may inhibit his advice to the wife he must cease to act for her.

These steps lay down straightforward practical guidance for the normal case, but where the lender is aware of particular circumstances that increase the risk of impropriety, it needs to take additional precautions: for example, by making sure that the wife is advised by a solicitor who is not also representing the husband.[148]

147 *Per* Lord Scott at [175].

148 *Per* Lord Scott at [174].

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4 CONTROL OF MORTGAGE TERMS

The underlying principle is freedom of contract: the parties should be free to determine the terms of their loan and any mortgage to secure its repayment. But throughout the history of money lending, there has been a recognition that '*necessitous men are not, truly speaking, free men*'[149] and thus borrowers may require a level of protection against the often stronger bargaining power of lenders. The focus of this protection has changed as social and economic conditions have altered the nature of borrowers and their borrowing.

In early times, the laws against usury initially prohibited, and then controlled, interest rates to protect the souls of all. We have seen that, under the traditional mortgage by conveyance, the Chancery courts from the seventeenth century onwards would protect the borrower's right to redeem, so that the mortgage took effect only by way of security. Borrowers during this period were often landowners who needed relatively short-term financial relief, but, with the growing impact of the Industrial Revolution, the expansion of the Empire, and the importance of trade, the nineteenth century saw a growth in commercial borrowers. More often than not, they were astute businessmen who were able to wield sufficient negotiating power to look after themselves. Accordingly, protection of the equity of redemption on mortgages taken out to finance the business exploits of these borrowers became less of a priority.

We have also noted that equity would frustrate the exploitation of particularly vulnerable borrowers by setting aside unconscionable bargains. This equitable jurisdiction was originally intended to protect heirs mortgaging their prospective interests in their family's landed estates, but it developed into a general jurisdiction to protect all vulnerable borrowers. It has been employed to vary mortgage terms that are demonstrably oppressive or unconscionable—a contribution that remains of significance today where borrowing is not subject to statutory control.

In more recent times, it is the cash-strapped individual consumer who is more often in need of protection from institutional lenders. Government has come to his or her relief through legislation that, as we have already examined, operates initially through market regulation, but may also intervene to control mortgage terms.

The primary targets of control have been terms that inhibited redemption, terms that determine the level or fluctuation of interest rates, whether as a result of market conditions or upon the borrower's default, and terms that provide for some collateral advantage to the lender. In our survey of the legal control of mortgage terms, we will look first at the common law, equitable, and statutory control mechanisms, before examining how these mechanisms operate to control these different types of term.

4.1 SOURCES OF CONTROL

4.1.1 The common law

Common law controls are few, but the restraint of trade doctrine has been pressed into service to control collateral advantages that require the borrower to purchase products solely from the lender. Nowadays, extensive competition laws and market regulation pro-

[149] *Vernon v Bethell* (1761) 2 Eden 113, *per* Lord Nottingham.

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vide a more effective and comprehensive framework to promote a free market domestically, globally, and within the European context.

Implied terms have provided some limited control over the power of lenders to vary interest rates where an appeal to control on grounds of public policy has failed.

4.1.2 Equitable control

Equitable control of mortgage terms is derived from two sources.[150] First, equity's protection against unconscionable bargains has been applied to vary oppressive and unconscionable mortgage terms, where both substantive and procedural unconscionability is established, and now underpins equity's most effective intervention.

Secondly, using the clogs and fetters doctrine, equity has struck down terms that bar or inhibit the borrower's equitable right to redeem. The origin of this jurisdiction was described by Lord Haldane in the following leading case.

G&K Kreglinger v New Patagonia Meat and Cold Storage Co Ltd
[1914] AC 25, HL

Lord Haldane

At 35

The reason for which a Court of Equity will set aside the legal title of a mortgagee and compel him to reconvey the land on being paid principal, interest, and costs is a very old one. It appears to owe its origin to the influence of the Church in the Courts of the early Chancellors. As early as the Council of Lateran in 1179, we find, according to Matthew Paris (*Historia Major*, 1684 ed. at pp. 114–115), that famous assembly of ecclesiastics condemning usurers and laying down that when a creditor had been paid his debt he should restore his pledge. It was therefore not surprising that the Court of Chancery should at an early date have begun to exercise jurisdiction in personam over mortgagees. This jurisdiction was merely a special application of a more general power to relieve against penalties and to mould them into mere securities. The case of the common law mortgage of land was indeed a gross one. The land was conveyed to the creditor upon the condition that if the money he had advanced to the feoffor was repaid on a date and at a place named, the fee simple should revest in the latter, but that if the condition was not strictly and literally fulfilled he should lose the land for ever. What made the hardship on the debtor a glaring one was that the debt still remained unpaid and could be recovered from the feoffor notwithstanding that he had actually forfeited the land to his mortgagee. Equity, therefore, at an early date began to relieve against what was virtually a penalty by compelling the creditor to use his legal title as a mere security.

My Lords, this was the origin of the jurisdiction which we are now considering, and it is important to bear that origin in mind. For the end to accomplish which the jurisdiction has been evolved ought to govern and limit its exercise by equity judges. That end has always been to ascertain, by parol evidence if need be, the real nature and substance of the transaction, and if it turned out to be in truth one of mortgage simply, to place it on that footing. It was, in ordinary cases, only where there was conduct which the Court of Chancery regarded as unconscientious that it interfered with freedom of contract. The lending of money, on mortgage or otherwise, was looked on with suspicion, and the Court was on the alert to discover

[150] Bamford, 'Lord Macnaghten's Puzzle: The Mortgage of Real Property in English Law' [1996] CLP 207.

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> want of conscience in the terms imposed by lenders. But whatever else may have been the intention of those judges who laid the foundations of the modern doctrines with which we are concerned in this appeal, they certainly do not appear to have contemplated that their principle should develop consequences which would go far beyond the necessities of the case with which they were dealing and interfere with transactions which were not really of the nature of a mortgage, and which were free from objection on moral grounds. Moreover, the principle on which the Court of Chancery interfered with contracts of the class under consideration was not a rigid one. The equity judges looked, not at what was technically the form, but at what was really the substance of transactions, and confined the application of their rules to cases in which they thought that in its substance the transaction was oppressive [. . .] The principle was thus in early days limited in its application to the accomplishment of the end which was held to justify interference of equity with freedom of contract. It did not go further. As established it was expressed in three ways. The most general of these was that if the transaction was once found to be a mortgage, it must be treated as always remaining a mortgage and nothing but a mortgage. That the substance of the transaction must be looked to in applying this doctrine and that it did not apply to cases which were only apparently or technically within it but were in reality something more than cases of mortgage, *Howard v. Harris* (1683) 1 Vern 33 2 Ch Cas 147 and other authorities shew.

Equity's protection of the equitable right to redeem has been gradually eroded away since its heyday, when any clog or fetter on the borrower's right to recover his or her property was struck down. It does continue to be of significance where a device bars the right to redeem. This remaining intervention has been the subject of criticism by both judges and commentators.[151] In *Jones v Morgan*,[152] the Master of the Rolls, Lord Phillips, suggested that '[the] *doctrine of a clog on the equity of redemption is* [. . .] *an appendix to our law which no longer serves a useful purpose and would be better excised*'. The Law Commission has made such a recommendation, but the doctrine continues to limp along, causing more problems than it solves.[153]

We should add one further equitable contribution to the regulation of mortgage terms: the prohibition on penalties. Equity will strike down a provision that provides for a payment to be made by a party in default that is not a genuine pre-estimation of the loss that the innocent party may suffer.[154]

4.1.3 Statutory consumer control

We have already noted the extensive regulation of the domestic credit market both through the FSMA 2000, which regulates most first mortgages over dwelling houses, and the CCA

[151] See Devonshire, 'The Modern Application of the Rule Against Clogs in The Equity of Redemption' (1997) 5 APLJ 1; Thompson, 'Do We Really Need Clogs?' [2001] Conv 502; Duncan and Wilmott, 'Clogging the Equity of Redemption: An Outmoded Concept' (2002) 2 QUTLJJ 35; Berg, 'Clogs on the Equity of Redemption: Or Chaining an Unruly Dog' [2002] JBL 335; Devenney, 'A Pack of Unruly Dogs: Unconscionable Bargains, Lawful Act (Economic) Duress and Clogs on the Equity of Redemption' (2002) JBL 539; Watt, 'Mortgage Law as Fiction' in *Modern Studies in Property Law: Vol 4* (ed Cooke, 2007, p 89).

[152] [2001] EWCA Civ 995, [72].

[153] Law Commission Report No 204, Land Mortgages (2001, Part VIII).

[154] *Dunlop Pneumatic Tyre Ltd v New Garage and Motor Co Ltd* [1915] AC 79; *Philips Hong Kong Ltd v AG of Hong Kong* (1993) 61 BLR 41.

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1974 (as amended), which governs much of the secondary secured lending market.[155] Inevitably, these regulatory controls impact upon mortgage terms.

Another source of protection arises from the treatment of borrowers as consumers and entitled to general consumer protection. This consumer protection is to be found in the Unfair Terms in Consumer Contract Regulations 1999[156] and the Unfair Practices Regulations 2008.[157] After some initial hesitation, it is clear that these regulations do apply to contracts affecting land, including mortgages.[158] They apply to individual borrowers, but not companies. Thus they may be used to control the fairness of terms and practices governing many non-commercial mortgages, whether regulated under the FSMA 2000 or the CCA 1974.

An unfair term is not binding on the borrower.[159] The OFT also acts at a regulatory level as a consumer watchdog by considering and taking action on complaints made both by consumers and consumer organizations, by investigating and providing guidance on potentially unfair terms and practices in consumer contracts, and by issuing proceedings by way of injunction to restrain the use of unfair terms.[160] The OFT rarely has to resort to judicial proceedings, but, instead, will extract an undertaking from an offending lender to alter its loan terms or practices. The OFT's tactics appear to work, with its bulletins full of reports of terms that have been altered, so triggering a ripple effect on other lenders with similar terms and conditions.[161]

The OFT issued its initial guidance on the 1999 Regulations in 2001 and updated this guidance in 2008.[162] It has also issued joint guidance, with the Department of Business Enterprise and Regulatory Reform (BERR) upon the 2008 Regulations.[163] Further specific guidance has been issued on *Calculating Fair Default Charges on Credit Card Contracts*, which has wider implications for similar default charges found in mortgages.[164]

The definition of an unfair term is found in regs 5 and 6 of the 1999 Regulations.

Unfair Terms in Consumer Contracts Regulations 1999, regs 5 and 6

Unfair terms

5.—(1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

(2) A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.

155 See section 2 above.

156 SI 1999/2083, which amends and replaces the original regulations in SI 1994/3159. The OFT has issued a guidance note on the Regulations: see OFT 143 (2005). These Regulations were enacted in pursuance of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

157 SI 2008/1277, enacted in pursuance of Council Directive 2005/29/EC of 11 May 2005 on unfair business-to-consumer commercial practices in the internal market (the Unfair Commercial Practices Directive).

158 *Newham LBC v Khatun* [2004] EWCA Civ 55, [2005] QB 37.

159 Unfair Terms in Consumer Contracts Regulations 1999, reg 8.

160 Ibid, regs 10–15. Certain other bodies are also granted supervisory powers.

161 Bright, 'Winning the Battle Against Unfair Contract Terms' (2000) 20 Legal Studies 331.

162 OFT 311 (January 2008).

163 See OFT, *Guidance on the UK Regulations: Implementing the Unfair Commercial Practices Directive* (2008).

164 OFT 842 (2006).

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(3) Notwithstanding that a specific term or certain aspects of it in a contract has been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of it indicates that it is a pre-formulated standard contract.

(4) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.

(5) Schedule 2 to these Regulations contains an indicative and non-exhaustive list of the terms which may be regarded as unfair.

Assessment of unfair terms

6.—(1) Without prejudice to regulation 12, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

(2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate—

(a) to the definition of the main subject matter of the contract, or

(b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

The focus of the requirement of fairness is upon standard terms and conditions, which are not individually negotiated by the lender and the borrower.[165] The core terms of the contract are excluded from the requirement for fairness, but must be expressed in plain intelligible language.[166] Core terms are those terms that relate to the main subject matter of the contract or the adequacy of the consideration.[167]

It is suggested that the core terms of a mortgage should be restricted to the amount of the loan and the level of interest chargeable. In this regard the Supreme Court in *Abbey National v OFT*[168] held that not only the 'essential' price but also an 'ancillary' price constituted the core term so that the fairness of unauthorized overdraft charges could not be scrutinized under the 1999 Regulations since they formed part of the price for the overall package of banking services provided by the bank to its current account customers. Nevertheless, the House of Lords, in *Director General of Fair Trading v First National Bank plc*,[169] has made clear that the interpretation of 'core terms' is to be restrictively construed and, thus, did not extend to additional charges payable as a result of the borrower's default. The case concerned the right of the bank, under a contractual term, to continue to claim interest at the contractual rate (rather than at the statutory rate applicable to judgment debts) until the total amount of any judgment debt obtained after the borrower's default had been discharged. Lord Steyn (referring to the earlier form of the Regulations) made the following observation.

[165] Unfair Terms in Consumer Contracts Regulations 1999, reg 5(2). See *UK Housing Alliance (North West) Ltd v Francis* [2010] EWCA Civ 117.

[166] Ibid, reg 6(2). [167] Ibid.

[168] [2010] 1 AC 696. [169] [2001] UKHL 52.

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Director General of Fair Trading v First National Bank plc
[2002] 1 AC 481, HL

Lord Steyn

At [34]

Clause 8 of the contract, the only provision in dispute, is a default provision. It prescribes remedies which only become available to the lender upon the default of the consumer. For this reason the escape route of regulation 3(2) is not available to the bank. So far as the description of terms covered by regulation 3(2) as core terms is helpful at all, I would say that clause 8 of the contract is a subsidiary term. In any event, article 3(2) must be given a restrictive interpretation. Unless that is done article 3(2)(a) will enable the main purpose of the scheme to be frustrated by endless formalistic arguments as to whether a provision is a definitional or an exclusionary provision. Similarly, article 3(2)(b) dealing with "the adequacy of the price of remuneration" must be given a restrictive interpretation. After all, in a broad sense all terms of the contract are in some way related to the price or remuneration. That is not what is intended. Even price escalation clauses have been treated by the Director as subject to the fairness provision [. . .] It would be a gaping hole in the system if such clauses were not subject to the fairness requirement.

The test of unfairness found in reg 5(1) encompasses both a lack of good faith, and a significant imbalance in the rights and liabilities of the parties, which operates to the detriment of the borrower. Schedule 2 of the 1999 Regulations illustrates the test by setting out a non-exhaustive 'grey list' of terms, which potentially may be regarded as unfair: for example, para (e) provides that a term '*requiring any consumer who fails to fulfill his obligation to pay a disproportionately high sum in compensation*' is potentially unfair. The grey list's focus is upon the substantive rights and obligations of the parties, but it has been suggested that the good faith requirement also adds an element of procedural fairness.[170]

Lord Bingham, giving the leading judgment in *Director General of Fair Trading v First National Bank*, clearly contemplated that good faith called for procedural fairness in how the loan is entered into.

Director General of Fair Trading v First National Bank plc
[2002] 1 AC 481, HL

Lord Bingham

At [17]

[Referring to the earlier form of the Regulations] [. . .] [T]he language used in expressing the test, so far as applicable in this case, is in my opinion clear and not reasonably capable of differing interpretations. A term falling within the scope of the regulations is unfair if it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirement of good faith. The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour. This may be by the granting to the supplier of a beneficial option or discretion or

[170] Collins, 'Good Faith in European Contract Law' (1994) 14 OJLS 229; Beale, 'Legislative Control of Fairness: The Directive on Unfair Terms in Consumer Contracts' in *Good Faith and Fault in Contract Law* (eds Beatson and Friedman, 1995), p 231.

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power, or by the imposing on the consumer of a disadvantageous burden or risk or duty. The illustrative terms set out in Schedule 3 to the regulations provide very good examples of terms which may be regarded as unfair; whether a given term is or is not to be so regarded depends on whether it causes a significant imbalance in the parties' rights and obligations under the contract. This involves looking at the contract as a whole. But the imbalance must be to the detriment of the consumer; a significant imbalance to the detriment of the supplier, assumed to be the stronger party, is not a mischief which the regulations seek to address. The requirement of good faith in this context is one of fair and open dealing. Openness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in Schedule 2 of the regulations. Good faith in this context is not an artificial or technical concept; nor, since Lord Mansfield was its champion, is it a concept wholly unfamiliar to British lawyers. It looks to good standards of commercial morality and practice. Regulation 4(1) lays down a composite test, covering both the making and the substance of the contract, and must be applied bearing clearly in mind the objective which the regulations are designed to promote.

Furthermore, the 1999 regulations require terms to be expressed in plain and intelligible language.

Unfair Terms in Consumer Contracts Regulations 1999, reg 7

Written contracts

1. A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language.

2. If there is doubt about the meaning of a written term, the interpretation which is most favourable to the consumer shall prevail but this rule shall not apply in proceedings brought under regulation 12.

The terms must be capable of being understood by ordinary members of the public and not only lawyers or other experts.[171] If there is any doubt in meaning, a term is to be construed in favour of the borrower.[172] These requirements present a challenge where the subject matter is inherently complex—yet in *Office of Fair Trading v Abbey National plc*,[173] the court was unimpressed by arguments that complexity should affect the standard. It is the comprehensibility of the result that was important. It was no excuse that a reasonable attempt to explain complex subject matter had been made, if a layman would still fail to grasp its meaning. The aim of comprehensibility is supported by prohibition on terms that a borrower has no real opportunity to consider before the mortgage is completed.[174]

The message is clear: lenders must make sure that their standard terms and conditions meet the standards of fairness required by the legislation, and illustrated by the OFT's

171 'Cleared funds' was considered by the OFT to be unclear to consumers: see OFT Bulletin 16.
172 Unfair Terms in Consumer Contracts Regulations, reg 7(2).
173 [2008] EWHC 875.
174 See Consumer Credit Act 1974 (as amended), Sch 1, para 1(i).

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guidance.[175] Furthermore, lenders must ensure that the import of those terms and conditions are brought home to the borrower, both because they can be understood by any layman, and also because there is a process that ensures that borrowers are given an opportunity to read and consider these terms before they are bound. The indications are that certain, but not all, lenders have received and understood that message.[176]

The 2008 Regulations,[177] in contrast to the 1999 Regulations, are enforceable only by the OFT as part of its regulatory armory.[178] They introduce a general duty upon traders not to trade unfairly,[179] and seek to ensure that they act honestly and fairly towards customers by prohibiting misleading actions,[180] omissions,[181] and aggressive commercial practices.[182] Certain specific practices contained in the Schedule to the 2008 Regulations are always considered unfair. It is anticipated that these Regulations, like the 1999 Regulations, will apply to the practices of lenders when dealing with individual borrowers.

4.2 PARTICULAR MORTGAGE TERMS: REDEMPTION

At the heart of the clogs and fetters doctrine is the protection of the borrower's equity of redemption, and the attendant right of the borrower to repay the loan and redeem, or recover, the land free of the lender's mortgage. Any device that could prevent the borrower from exercising his or her right to redeem will be struck down.

4.2.1 Options to purchase

The most common example of a device falling foul of this principle is the grant to the lender of an option to purchase the mortgaged property, although the courts have become increasingly frustrated with this assault on the parties' freedom to agree commercial terms.

Lord Halsbury expressed such sentiments in the following case.

Samuel v Jarrah Timber & Wood Paving Corporation Ltd
[1904] AC 323, HL

Lord Halsbury

At 323

A perfectly fair bargain made between two parties to it, each of whom was quite sensible of what they were doing, is not to be performed because at the same time a mortgage arrangement was made between them. If a day had intervened between the two parts of the arrangement, the part of the bargain which the appellant claims to be performed would have been perfectly good and capable of being enforced; but a line of authorities going back for

[175] See generally Simmonds, 'Bankers' Documents and the Unfair Terms in Consumer Contracts Regulations 1999' (2002) 17 JIBL 205.

[176] The FSA's *Report on Fairness of Terms in Consumer Contracts* (2008, available online at http://www.fsa.gov.uk) found that some lenders, particularly smaller lenders, are unaware of the need to comply with the 1999 Regulations.

[177] SI 2008/1277. They came into force on 26 May 2008.

[178] *McGuffick v Royal Bank of Scotland* [2009] EWHC 2386.

[179] Unfair Practices Regulations 2008, reg 3.

[180] Ibid, reg 5. [181] Ibid, reg 6. [182] Ibid, reg 7.

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more than a century has decided that such an arrangement as that which was here arrived at is contrary to a principle of equity, the sense or reason of which I am not able to appreciate, and very reluctantly I am compelled to acquiesce in the judgments appealed from.

Lord Halsbury refers to the fact that if a day had intervened between the mortgage and the option, the transactions would have been upheld.

The principle is not quite as easily avoided. It must be evident that the mortgage and the option are separate transactions in substance, and not merely in form.[183] For example, in *Jones v Morgan*,[184] an option granted some three years after the date of the original mortgage was struck down because the Court took the view that the option formed part of a variation of the original mortgage. It was of no matter that the Court also found that the option was neither an unconscionable bargain, nor extracted as a result of economic duress.[185]

Echoing the words of Lord Haldane in *Krelinger* (extract at 4.1.2 above), the transaction must also be, in substance, a mortgage—an issue that was central to the following case.[186]

Warnborough Ltd v Garmite Ltd
[2003] EWCA Civ 1544, CA

Facts: Warnborough sold land to Garmite, leaving the purchase money outstanding, but secured by a mortgage to Warnborough. At the same time, Garmite granted Warnborough an option to repurchase the land for the original sale price as a further protection against the risk that the purchase price would not be paid. The option was not a fetter on the equity of redemption, because the transaction was, in substance, a sale and purchase, not a mortgage.

Jonathan Parker LJ

At [72]–[73]

In the light of the authorities to which I have referred, it has to be accepted that the "unruly dog" is still alive (although one might perhaps reasonably expect its venerable age to inhibit it from straying too far or too often from its kennel); and that however desirable an appendectomy might be thought to be, no such relieving operation has as yet been carried out. Indeed, Mr Teverson did not seek to contend otherwise.

That said, it is in my judgment glaringly clear from the authorities that the mere fact that, contemporaneously with the grant of a mortgage over his property, the mortgagor grants the mortgagee an option to purchase the property does no more than raise the question whether the rule against 'clogs' applies: it does not begin to answer that question. As has been said over and over again in the authorities, in order to answer that question the court has to look at the 'substance' of the transaction in question: in other words, to inquire as to the true nature of the bargain which the parties have made. To do that, the court examines all the circumstances, with the assistance of oral evidence if necessary.

183 See *Reeve v Lisle* [1902] AC 461; *Lewis v Frank Love* [1961] 1 WLR 261.

184 [2001] EWCA Civ 995.

185 Devenney, 'A Pack of Unruly Dogs: Unconscionable Bargain, Lawful Act (Economic) Duress and Clogs on the Equity of Redemption' [2002] JBL 539.

186 See also *Brighton & Hove CC v Audus* [2009] EWHC 340.

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4.2.2 Postponement of the right to redeem

The postponement of the right to redeem is not, per se, an unacceptable clog on the equity of redemption. A postponement will be struck down if it renders the right to redeem illusory. For example, in *Fairclough v Swan Brewery Co*,[187] the right to redeem was held to be illusory where the borrower could not repay the loan until just six weeks prior to the expiry of the mortgaged leasehold term.

A postponement will also be struck down if it is oppressive or unconscionable; unreasonableness is insufficient. This conclusion was reached in the following case, in a judgment that illustrates the courts' reluctance to interfere with the freedom of contract of commercial parties.

Knightsbridge Estates Trust Ltd v Byrne
[1939] Ch 441, CA

Facts: Knightsbridge mortgaged a number of freehold properties to secure a loan of £300,000, with interest payable at 6.5 per cent. In 1931, the company renegotiated the loan on more favourable terms. It was to be repayable by eighty half-yearly instalments (i.e. over forty years), with interest at 5.25 per cent, and the lender agreed not to call in the loan, provided that the borrower performed the loan terms. Interest rates fell further and Knightsbridge wished to repay the loan to obtain still more favourable terms.

Greene MR

At 453

The first argument was that the postponement of the contractual right to redeem for forty years was void in itself, in other words, that the making of such an agreement between mortgagor and mortgagee was prohibited by a rule of equity. It was not contended that a provision in a mortgage deed making the mortgage irredeemable for a period of years is necessarily void. The argument was that such a period must be a "reasonable " one, and it was said that the period in the present case was an unreasonable one by reason merely of its length. This argument was not the one accepted by the learned judge.

Now an argument such as this requires the closest scrutiny, for, if it is correct, it means that an agreement made between two competent parties, acting under expert advice and presumably knowing their own business best, is one which the law forbids them to make upon the ground that it is not "reasonable." If we were satisfied that the rule of equity was what it is said to be, we should be bound to give effect to it. But in the absence of compelling authority we are not prepared to say that such an agreement cannot lawfully be made. A decision to that effect would, in our view, involve an unjustified interference with the freedom of business men to enter into agreements best suited to their interests and would impose upon them a test of "reasonableness" laid down by the Courts without reference to the business realities of the case.

It is important to remember what those realities were. The respondents are a private company and do not enjoy the facilities for raising money by a public issue possessed by public companies. They were the owners of a large and valuable block of property, and so far as we know they had no other assets. The property was subject to a mortgage at a high rate of interest and this mortgage was liable to be called in at any time. In these circumstances the

[187] [1912] AC 565.

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respondents were, when the negotiations began, desirous of obtaining for themselves two advantages: (1.) a reduction in the rate of interest, (2.) the right to repay the mortgage moneys by instalments spread over a long period of years. The desirability of obtaining these terms from a business point of view is manifest, and it is not to be assumed that these respondents were actuated by anything but pure considerations of business in seeking to obtain them. The sum involved was a very large one, and the length of the period over which the instalments were spread is to be considered with reference to this fact. In the circumstances it was the most natural thing in the world that the respondents should address themselves to a body desirous of obtaining a long term investment for its money. The resulting agreement was a commercial agreement between two important corporations experienced in such matters, and has none of the features of an oppressive bargain where the borrower is at the mercy of an unscrupulous lender. In transactions of this kind it is notorious that there is competition among the large insurance companies and other bodies having large funds to invest, and we are not prepared to view the agreement made as anything but a proper business transaction.

But it is said not only that the period of postponement must be a reasonable one, but that in judging the "reasonableness" of the period the considerations which we have mentioned cannot be regarded; that the Court is bound to judge "reasonableness" by a consideration of the terms of the mortgage deed itself and without regard to extraneous matters. In the absence of clear authority we emphatically decline to consider a question of "reasonableness" from a standpoint so unreal. To hold that the law is to tell business men what is reasonable in such circumstances and to refuse to take into account the business considerations involved, would bring the law into disrepute. Fortunately, we do not find ourselves forced to come to any such conclusion [. . .]

But in our opinion the proposition that a postponement of the contractual right of redemption is only permissible for a "reasonable" time is not well-founded. Such a postponement is not properly described as a clog on the equity of redemption, since it is concerned with the contractual right to redeem. It is indisputable that any provision which hampers redemption after the contractual date for redemption has passed will not be permitted. Further, it is undoubtedly true to say that a right of redemption is a necessary element in a mortgage transaction, and consequently that, where the contractual right of redemption is illusory, equity will grant relief by allowing redemption [. . .]

Moreover, equity may give relief against contractual terms in a mortgage transaction if they are oppressive or unconscionable, and in deciding whether or not a particular transaction falls within this category the length of time for which the contractual right to redeem is postponed may well be an important consideration. In the present case no question of this kind was or could have been raised.

But equity does not reform mortgage transactions because they are unreasonable. It is concerned to see two things—one that the essential requirements of a mortgage transaction are observed, and the other that oppressive or unconscionable terms are not enforced. Subject to this, it does not, in our opinion, interfere. The question therefore arises whether, in a case where the right of redemption is real and not illusory and there is nothing oppressive or unconscionable in the transaction, there is something in a postponement of the contractual right to redeem, such as we have in the present case, that is inconsistent with the essential requirements of a mortgage transaction? Apart from authority the answer to this question would, in our opinion, be clearly in the negative. Any other answer would place an unfortunate restriction on the liberty of contract of competent parties who are at arm's length—in the present case it would have operated to prevent the respondents obtaining financial terms which for obvious reasons they themselves considered to be most desirable. It would, moreover, lead to highly inequitable results. The remedy sought by the

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> respondents and the only remedy which is said to be open to them is the establishment of a right to redeem at any time on the ground that the postponement of the contractual right to redeem is void. They do not and could not suggest that the contract as a contract is affected, and the result would accordingly be that whereas the respondents would have had from the first the right to redeem at any time, the appellants would have had no right to require payment otherwise than by the specified instalments. Such an outcome to a bargain entered into by business people negotiating at arm's length would indeed be unfortunate, and we should require clear authority before coming to such a conclusion.

4.2.3 Charges for early redemption

It is common practice for lenders to offer advantageous rates of interest to domestic borrowers who agree that they will not redeem for a fixed period. Lenders benefit from the certainty of receiving a known return on their investment for the fixed term. The price to be paid for these advantageous rates of interest is payment of an agreed sum should the borrower wish to redeem before the fixed period has expired. Such charges are a frequent cause of complaint by borrowers, although regulations under both the FSMA 2000 and the CCA 1974 require such charges to be explained to the borrower, and to be calculated as a genuine pre-estimation of the lender's loss. A redemption charge that fails to do so also runs the risk of being unfair, under s 140A of the 1974 Act or under the 1999 Regulations,[188] or exorbitant under the MCOB rules. It is also conceivable that a redemption charge could be held to be an oppressive and unconscionable term or a penalty.

4.3 PARTICULAR MORTGAGE TERMS COLLATERAL ADVANTAGES

A collateral advantage is an added benefit that the lender negotiates as a condition of the mortgage. The most common examples are the tied and solus agreements that a brewery or petrol company requires of its retailers. These agreements are often associated with a mortgage, which, together, operate to require the borrower to purchase their supplies solely from the lender as a condition of the lender providing loan facilities to purchase, improve, or support the borrower's business. They thus occur most commonly in the commercial lending environment,[189] where regulation operates through equitable controls or the common law, and statutory controls on competition. A collateral advantage encountered in the domestic lending market will be subject to the regulatory controls of the FSMA 2000 and CCA 1974, as well as the fairness test demanded by s 140A of the 1974 Act and the 1999 Regulations.[190]

4.3.1 Equitable controls

Historically, equity would strike down any collateral advantage. When the usury laws limited interest rates, a collateral advantage was considered an illegal means of avoiding these

[188] *Falco Finance Ltd v Gough* [1999] CCLR 16; *Evans v Cherry Tree Finance Ltd* [2008] EWCA Civ 331.

[189] Although see *Cityland and Property Holdings Ltd v Dabrah* [1968] Ch 166, in which a premium on the amount repayable over the amount lent was characterized as a collateral advantage.

[190] For instance, the way in which payment protection insurance was sold by lenders, or their associated companies, began to look suspiciously like a collateral advantage.

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limits. With the abolition of the usury laws and the surge in economic activity of the nineteenth century, equity's abhorrence of collateral advantages waned. Initial relaxation was exemplified in the cases of *Biggs v Hodinott*[191] and *Bradley v Carritt*,[192] in which collateral advantages limited to the life of the mortgage were accepted. A collateral advantage that could extend beyond the life of the mortgage was seen as an unacceptable clog on the equity of redemption, because the borrower would not be able to redeem his or her property free of this burden.[193]

Further relaxation flowed from the following landmark decision.

G&K Kreglinger v New Patagonia Meat and Cold Storage Co Ltd
[1914] AC 25, HL

Facts: Kreglinger advanced the meat company funds that were secured by a floating charge. In addition to the loan, Kreglinger negotiated a right of pre-emption to purchase any sheepskins produced by the meat company over a five-year period, for the best market price, and to be paid a commission on any sheepskins that the meat company sold to third parties. The meat company redeemed the loan within the five-year option period and unsuccessfully claimed that it should be free of its obligations regarding the sale of the sheepskins.

Lord Haldane LC

At 37

The Legislature during a long period placed restrictions on the rate of interest which could legally be exacted. But equity went beyond the limits of the statutes which limited the interest, and was ready to interfere with any usurious stipulation in a mortgage. In so doing it was influenced by the public policy of the time. That policy has now changed, and the Acts which limited the rate of interest have been repealed. The result is that a collateral advantage may now be stipulated for by the mortgagee provided that he has not acted unfairly or oppressively, and provided that the bargain does not conflict with the third form of the principle. This is that a mortgage [. . .] cannot be made irredeemable, and that any stipulation which restricts or clogs the equity of redemption is void. It is obvious that the reason for the doctrine in this form is the same as that which gave rise to the other forms. It is simply an assertion in a different way of the principle that once a mortgage always a mortgage and nothing else.

My Lords, the rules I have stated have now been applied by Courts of Equity for nearly three centuries, and the books are full of illustrations of their application. But what I have pointed out shews that it is inconsistent with the objects for which they were established that these rules should crystallize into technical language so rigid that the letter can defeat the underlying spirit and purpose. Their application must correspond with the practical necessities of the time. The rule as to collateral advantages, for example, has been much modified by the repeal of the usury laws and by the recognition of modern varieties of commercial bargaining. In *Biggs v. Hoddinott* [1898] 2 Ch. 307 it was held that a brewer might stipulate in a mortgage made to him of an hotel that during the five years for which the loan was to continue the mortgagors would deal with him exclusively for malt liquor. In the seventeenth and eighteenth centuries a Court of Equity could hardly have so decided, and the judgment illustrates the elastic character of equity jurisdiction and the power of equity judges to mould

191 [1898] 2 Ch 307. 192 [1903] AC 25. 193 *Noakes v Rice* [1902] AC 24.

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the rules which they apply in accordance with the exigencies of the time. The decision proceeded on the ground that a mortgagee may stipulate for a collateral advantage at the time and as a term of the advance, provided, first, that no unfairness is shewn, and, secondly, that the right to redeem is not thereby clogged. It is no longer true that, as was said in *Jennings v. Ward* 2 Vern. 520, "a man shall not have interest for his money and a collateral advantage besides for the loan of it." Unless such a bargain is unconscionable it is now good. But none the less the other and wider principle remains unshaken, that it is the essence of a mortgage that in the eye of a Court of Equity it should be a mere security for money, and that no bargain can be validly made which will prevent the mortgagor from redeeming on payment of what is due, including principal, interest, and costs. He may stipulate that he will not pay off his debt, and so redeem the mortgage, for a fixed period. But whenever a right to redeem arises out of the doctrine of equity, he is precluded from fettering it. This principle has become an integral part of our system of jurisprudence and must be faithfully adhered to.

My Lords, the question in the present case is whether the right to redeem has been interfered with. And this must, for the reasons to which I have adverted in considering the history of the doctrine of equity, depend on the answer to a question which is primarily one of fact. What was the true character of the transaction? Did the appellants make a bargain such that the right to redeem was cut down, or did they simply stipulate for a collateral undertaking, outside and clear of the mortgage, which would give them an exclusive option of purchase of the sheepskins of the respondents? The question is in my opinion not whether the two contracts were made at the same moment and evidenced by the same instrument, but whether they were in substance a single and undivided contract or two distinct contracts. Putting aside for the moment considerations turning on the character of the floating charge, such an option no doubt affects the freedom of the respondents in carrying on their business even after the mortgage has been paid off. But so might other arrangements which would be plainly collateral, an agreement, for example, to take permanently into the firm a new partner as a condition of obtaining fresh capital in the form of a loan. The question is one not of form but of substance, and it can be answered in each case only by looking at all the circumstances, and not by mere reliance on some abstract principle, or upon the dicta which have fallen obiter from judges in other and different cases. Some, at least, of the authorities on the subject disclose an embarrassment which has, in my opinion, arisen from neglect to bear this in mind. In applying a principle the ambit and validity of which depend on confining it steadily to the end for which it was established, the analogies of previous instances where it has been applied are apt to be misleading. For each case forms a real precedent only in so far as it affirms a principle, the relevancy of which in other cases turns on the true character of the particular transaction, and to that extent on circumstances.

My Lords, if in the case before the House your Lordships arrive at the conclusion that the agreement for an option to purchase the respondents' sheepskins was not in substance a fetter on the exercise of their right to redeem, but was in the nature of a collateral bargain the entering into which was a preliminary and separable condition of the loan, the decided cases cease to present any great difficulty.

It is thus necessary to consider initially the substance of the transaction, and whether the advantage is part and parcel of the mortgage consideration or independent of it, despite being part of the parties' overall bargain—an enquiry that it is not always easy to conduct. One may then move on to consider whether the advantage is repugnant to the equitable grounds identified by Lord Parker in his judgment in *Kreglinger*.

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G&K Kreglinger v New Patagonia Meat and Cold Storage Co Ltd
[1914] AC 25, HL

Lord Parker

At 56

[. . .] [E]ither (1.) because it was unconscionable, or (2.) because it was in the nature of a penal clause clogging the equity arising on failure to exercise a contractual right to redeem, or (3.) because it was in the nature of a condition repugnant as well to the contractual as to the equitable right.

4.3.2 Restraint of trade

The ability of the law to strike down terms in restraint of trade has a long history, dating at least from Elizabethan times. A party's freedom to contract must be balanced against the wide public interest of the freedom of all to trade. The doctrine has been pressed into service on a number of occasions to attack collateral advantages in mortgages—not always with success. The doctrine has no application to a collateral advantage in a mortgage used to acquire the borrower's business premises,[194] in which there is no restraint of an existing trade, but may be applied to a collateral advantage in a mortgage taken over business premises that a borrower already owns. In these circumstances, the question of whether an attendant collateral advantage is in restraint of trade looks to the reasonableness of the protection it affords. In *Esso Petroleum Co Ltd v Harpers Garage (Stourport) Ltd*,[195] a mortgage that postponed the borrower's right to redeem for twenty-one years, and a connected solus agreement that required the borrower to purchase all of its petroleum products from Esso for a similar period, were struck down as unreasonable restraints on trade. Similar agreements for shorter terms of five years or so have been upheld.[196]

The utility of the doctrine is overshadowed by the extensive competition laws that now govern commercial activity.[197]

4.4 PARTICULAR MORTGAGE TERMS: INTEREST RATES

The rate of interest and other costs associated with borrowing is, of course, of central importance to both the borrower and the lender.

4.4.1 Fluctuating and index-linked interest rates

Gray and Gray[198] have observed the surprising acceptance of the uncertainty inherent in the market norm of fluctuating or index-linked interest rates, which withstood attack on the basis of public policy in *Mutliservice Bookbinding Ltd v Marden*[199] (extracted below), and

194 *Cleveland Petroleum Ltd v Dartstone Ltd* [1969] 1 WLR 116; *Alec Lobb (Garages) Ltd v Total Oil Great Britain Ltd* [1985] 1 WLR 173.
195 [1968] AC 269. 196 Ibid; *Texaco v Mulberry Filling Station* [1972] 1 WLR 814.
197 Hopkins (1998) 49 NILQ 202.
198 Gray and Gray, *Elements of Land Law* (5th edn, 2009), [6.2.40]. 199 [1978] Ch 84.

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has not been questioned as being oppressive or unconscionable. The 1999 Regulations also accept that an interest rate in a mortgage will not be unfair because it is fluctuating or index-linked, provided (in the case of a fluctuating rate) that the lender gives notice to the borrower of any change and the borrower is able to redeem if he or she so wishes.[200]

The lender's discretion to alter a fluctuating interest rate is not, however, completely unfettered. The Court of Appeal, in the conjoined appeals of *Paragon Finance v Nash* and *Paragon Finance v Staunton*,[201] accepted two grounds upon which a term should be implied to define the manner in which a discretion should be exercised. The first implies a term that rates will not be altered improperly, arbitrarily, or capriciously, and the second, that, in exercising a discretion, the lender will not do so unreasonably—in the sense that no lender acting reasonably would act similarly.

Paragon Finance plc v Nash
[2002] 1 WLR 685, CA

Dyson LJ

At [30]–[32]

I cannot accept the submission of Mr Malek that the power given to the claimant by these loan agreements to set the interest rates from time to time is completely unfettered. If that were so, it would mean that the claimant would be completely free, in theory at least, to specify interest rates at the most exorbitant level. It is true that in the case of the Nash agreement clause 3.3 provides that the rate charged is that which applies to the category of business to which the claimant considers the mortgage belongs. That prevents the claimant from treating the Nashes differently from other borrowers in the same category. But it does not protect borrowers in that category from being treated in a capricious manner, or, for example, being subjected to very high rates of interest in order to force them into arrears with a view to obtaining possession of their properties.

The Stauntons do not even have the limited protection that is afforded by clause 3.3 of the Nash agreement. In the absence of an implied term, there would be nothing to prevent the claimant from raising the rate demanded of the Stauntons to exorbitant levels, or raising the rate to a level higher than that required of other similar borrowers for some improper purpose or capricious reason. An example of an improper purpose would be where the lender decided that the borrower was a nuisance (but had not been in breach of the terms of the agreement) and, wishing to get rid of him, raised the rate of interest to a level that it knew he could not afford to pay. An example of a capricious reason would be where the lender decided to raise the rate of interest because its manager did not like the colour of the borrower's hair.

It seems to me that the commercial considerations relied on by Mr Malek are not sufficient to exclude an implied term that the discretion to vary interest rates should not be exercised dishonestly, for an improper purpose, capriciously or arbitrarily. I shall come shortly to the question whether the discretion should also not be exercised unreasonably [. . .]

At [37]

I come, therefore, to the question whether the implied term should also extend to "unreasonably". The first difficulty is to define what one means by "unreasonably". Mr Bannister was

[200] See Unfair Terms in Consumer Contracts Regulations 1999, Sch 2, para 2(b) and (d).
[201] See also *Paragon Finance v Pender* [2005] EWCA Civ 760.

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at pains to emphasise that he was not saying that the rates of interest had to be reasonable rates in the sense of closely and consistently tracking LIBOR or the rates charged by the Halifax Building Society. He said that what he meant by the unreasonable exercise of the discretionary power to set the rate of interest was something very close to the capricious or arbitrary exercise of that power [. . .]

At [41]–[42]

So here, too, we find a somewhat reluctant extension of the implied term to include unreasonableness that is analogous to Wednesbury unreasonableness. I entirely accept that the scope of an implied term will depend on the circumstances of the particular contract. But I find the analogy of the *Gan Insurance case* [2001] EWCA Civ 1047 and the cases considered in the judgment of Mance LJ helpful. It is one thing to imply a term that a lender will not exercise his discretion in a way that no reasonable lender, acting reasonably, would do. It is unlikely that a lender who was acting in that way would not also be acting either dishonestly, for an improper purpose, capriciously or arbitrarily. It is quite another matter to imply a term that the lender would not impose unreasonable rates. It could be said that as soon as the difference between the claimant's standard rates and the Halifax rates started to exceed about two percentage points the claimant was charging unreasonable rates. From the defendant's point of view, that was undoubtedly true. But, from the claimant's point of view, it charged these rates because it was commercially necessary, and therefore reasonable, for it to do so.

I conclude therefore that there was an implied term of both agreements that the claimant would not set rates of interest unreasonably in the limited sense that I have described. Such an implied term is necessary in order to give effect to the reasonable expectations of the parties.

4.4.2 Excessive interest rates

The laws against usury set limits on the level of interest rates and, since their abolition, there have, from time to time, been monetary levels imposed upon interest rates for certain types of borrowing.[202] The modern thinking is against setting interest rate ceilings,[203] but to consider other mechanisms by which interest rates can be kept within acceptable bounds.

In the consumer market, these mechanisms are to be found both in the market regulation provisions of the FSMA 2000 and CCA 1974 and the controls over mortgage terms in the MCOB rules and s 140A of the 1974 Act (as amended).[204] For example, the MCOB rules prohibit excessive charges and the charging of compound interest—a mechanism of capitalizing interest that can lead to a sharp increase in the amount of the debt.[205] Compound

[202] See the Moneylenders Act 1900.

[203] See Department of Trade and Industry, *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century* (Cm 6040, 2003), [3.49]–[3.55].

[204] See *Barons Finance Ltd v Olubisi* (unreported 26 April 2010) where an interest rate of 3.5 per cent per month contributed to the unfairness of the relationship between the parties. Other factors included the urgency of the loan and breaches of the CCA 1974. High rates of interest has been found fair in high risk short terms loans secured on personal property eg cars often known as log book loans see *Nine Regions v Sadeer* (unreported 14 November 2008) and *Nine Regions v Singh* (unreported 14 January 2009).

[205] Compound interest is acceptable and common practice in commercial lending *The Maira* [1990] 1 AC 637; *Guardian Ocean Cargors Ltd v Banco Brasil SA (No 3)* [1992] 2 Lloyds Rep 193; *Westdeutsche Landesbank Girozentrale v Islington BC* [1996] AC 669.

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interest also contributed to the unfairness of the relationship under s 140A in *Patel v Patel*.[206] In respect of the 1999 Regulations, it should be noted that the interest rate will escape the requirement for fairness if it is a core term, although subsidiary provisions that deal with the calculation or variation of interest—for example, on default—will be caught.[207] Equity's jurisdiction over oppressive and unconscionable terms is also available, but presents a stricter test than the appropriate statutory controls.[208]

Where these statutory controls do not apply, for instance in the commercial context, equity's control of oppressive and unconscionable terms provides a final, although rather fragile, safety net.

The test of an oppressive and unconscionable term is strict, looking not only at the substantive fairness of the terms themselves, but also at the procedural fairness with which they were agreed, when the financial expertise and bargaining position of the parties is of central concern.

Multiservice Bookbinding Ltd v Marden
[1979] Ch 84, HC

Facts: Multiservice borrowed £36,000 from Marden to fund the purchase of new premises. The loan could not be redeemed for ten years; interest was calculated at 2 per cent above the bank rate on the entire amount of the loan, regardless of capital repayments, with arrears of interest being compounded after twenty-one days. In addition, any repayments of capital and interest were linked to the Swiss franc to protect the lender against sterling exchange rate fluctuations. Sterling did, indeed, decline in value against the Swiss franc, leaving the amount payable by Multiservice when it tried to redeem in excess of £133,000. Mutliservice unsuccessfully claimed that this result was oppressive and unconscionable.

Browne-Wilkinson J

At 104

[On public policy and indexation] [A]fter considering the arguments I do not feel that in 1977 I can declare that an index-linked money obligation is contrary to public policy. The reasons which lead me to this view are as follows: (1) If, as Denning L.J. said, the evil to be guarded against is that sterling will become discredited, this evil will flow not only from indexing by reference to the price of gold or Swiss franc, but equally from any other form of indexing, for example an obligation quantified by reference to the cost of living index. The evil lies in the revalorisation of the pound sterling by reference to any other yardstick, not in the nature of the yardstick itself. (2) Today a large number of obligations originally expressed in pounds sterling are varied by reference to an external yardstick. Long-term commercial contracts frequently include index linked obligations: so do many contracts of employment. The rent payable under certain leases has for centuries been made variable dependent upon the price of corn. More important, Parliament itself has authorised the linking of public service pensions to the

[206] [2009] EWHC 3264. Another aspect of unfairness was the manner in which the lender had acted including his poor record keeping.

[207] *Falco Finance Ltd v Gough* [1999] CCLR 16; *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52.

[208] See *Cityland & Property (Holdings) Ltd v Dabrah* [1968] Ch 166.

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cost of living and the issue of Savings Bonds similarly linked. It would be strange if Parliament had authorised transactions contrary to public policy. (3) Denning L.J. treated the process of index-linking as being a cause, not a symptom, of inflation. I know nothing of economics but it has been demonstrated to me that economists are not agreed that indexing has a deleterious effect in promoting inflation. It would, in my judgment, be wrong for the courts to declare that a particular class of transaction is against the public interest even though there is a body of better-informed opinion that takes the view that no harm is caused. It is for Parliament, with all its facilities for weighing the complex issues involved, to make a policy decision of this kind. (4) It seems to me that, even if there are good grounds for saying that indexing causes inflation, there may well be counter-availing considerations which would have to be weighed. In any economy where there is inflation there are few inducements to make long-term loans expressed in a currency the value of which is being eroded. It is at least possible that, unless lenders can ensure that they are repaid the real value of the money they advanced, and not merely a sum of the same nominal amount but in devalued currency, the availability of loan capital will be much diminished. This would surely not be in the public interest. (5) Shortly after 1956, the Cour de Cassation in France reversed its Policy referred to by Denning L.J. and allowed index-linked obligations even in domestic contracts. Index-linked obligations were held valid by the High Court of Australia in *Stanwell Park Hotel Co. Ltd. v. Leslie* (1952) 85 C.L.R. 189. Therefore I feel unable to follow the obiter dictum of Denning L.J. I need hardly say that I do so with considerable diffidence; but I receive some comfort from the fact that since he expressed his views, we have experienced 20 years of inflation and, on the somewhat analogous question whether a judgment of an English court can be expressed otherwise than in pounds sterling, he has departed from the nominalist principle which underlies his remarks in the *Treseder-Griffin case* [1956] 2 Q.B. 127. In my judgment, clause 6 of the mortgage is not contrary to public policy.

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[On oppressive and unconscionable terms] I therefore approach the second point on the basis that, in order to be freed from the necessity to comply with all the terms of the mortgage, the plaintiffs must show that the bargain, or some of its terms, was unfair and unconscionable: it is not enough to show that, in the eyes of the court, it was unreasonable. In my judgment a bargain cannot be unfair and unconscionable unless one of the parties to it has imposed the objectionable terms in a morally reprehensible manner, that is to say, in a way which affects his conscience.

The classic example of an unconscionable bargain is where advantage has been taken of a young, inexperienced or ignorant person to introduce a term which no sensible well-advised person or party would have accepted. But I do not think the categories of unconscionable bargains are limited: the court can and should intervene where a bargain has been procured by unfair means.

Mr. Nugee submitted that a borrower was, in the normal case, in an unequal bargaining position vis-à-vis the lender and that the care taken by the courts of equity to protect borrowers—to which Lord Parker referred in the passage I have quoted—was reflected in a general rule that, except in the case of two large equally powerful institutions, any unreasonable term would be "unconscionable" within Lord Parker's test. I cannot accept this. In my judgment there is no such special rule applicable to contracts of loan which requires one to treat a bargain as having been unfairly made even where it is demonstrated that no unfair advantage has been taken of the borrower. No decision illustrating Mr. Nugee's principle was cited. However, if, as in the *Cityland case* [1968] Ch. 166, there is an unusual or unreasonable stipulation the reason for which is not explained, it may well be that in the absence of any

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explanation, the court will assume that unfair advantage has been taken of the borrower. In considering all the facts, it will often be the case that the borrower's need for the money was far more pressing than the lenders need to lend: if this proves to be the case, then circumstances exist in which an unfair advantage could have been taken. It does not necessarily follow that what could have been done has been done: whether or not an unfair advantage has in fact been taken depends on the facts of each case.

Applying those principles to this case, first I do not think it is right to treat the "Swiss franc uplift" element in the capital-repayments as being in any sense a premium or collateral advantage. In my judgment a lender of money is entitled to insure that he is repaid the real value of his loan and if he introduces a term which so provides, he is not stipulating for anything beyond the repayment of principal [...] Secondly, considering the mortgage bargain as a whole, in my judgment there was no great inequality of bargaining power as between the plaintiffs and the defendant. The plaintiff company was a small but prosperous company in need of cash to enable it to expand: if it did not like the terms offered it could have refused them without being made insolvent or, as in the *Cityland case*, losing its home. The defendant had £40,000 to lend, but only, as he explained to the plaintiffs, if its real value was preserved. The defendant is not a professional moneylender and there is no evidence of any sharp practice of any kind by him. The borrowers were represented by independent solicitors of repute. Therefore the background does not give rise to any pre-supposition that the defendant took an unfair advantage of the plaintiffs [...] However, Mr. Nugee's other points amount to a formidable list and if it were relevant I would be of the view that the terms were unreasonable judged by the standards which the court would adopt if it had to settle the terms of a mortgage. In particular I consider that it was unreasonable both for the debt to be inflation proofed by reference to the Swiss franc and at the same time to provide for a rate of interest two per cent. above bank rate—a rate which reflects at least in part the unstable state of the pound sterling. On top of this interest on the whole sum advanced was to be paid throughout the term. The defendant made a hard bargain. But the test is not reasonableness. The parties made a bargain which the plaintiffs, who are businessmen, went into with their eyes open, with the benefit of independent advice, without any compelling necessity to accept a loan on these terms and without any sharp practice by the defendant. I cannot see that there was anything unfair or oppressive or morally reprehensible in such a bargain entered into in such circumstances.

4.4.3 Penalties and other onerous terms

In assessing the fairness of a consumer loan or the unconscionability of a commercial loan, it is significant to look not only at the interest rate, but also at the other terms of the agreement. Of particular import are terms that operate upon default and which may operate as a penalty, rather than a genuine pre-estimation of the lender's loss, or which may attract particular scrutiny under the MCOB rules, or against the test of fairness under s 140A of the CCA 1974 (as amended) or the 1999 Regulations.[209]

An increase in the rate of interest payable on arrears following default runs the risk of being a penalty, although a modest uplift in the interest rate payable on future interest payments following default may be acceptable, particularly in the commercial context.[210] A

[209] *County Leasing Ltd v East* [2007] EWHC 2907.

[210] Although see *Lordsvale Finance Ltd v Bank of Zambia* [1996] QB 752, in which an interest uplift of 1 per cent on future interest payments to be made following default was held not to be a penalty in a commercial loan.

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lower concessionary interest rate paid upon prompt payment is not generally regarded as a penalty,[211] although, in a consumer contract, it may still fall foul of the fairness test.

The case of *Falco Finance Ltd v Gough*[212] serves as an example. Mr Gough obtained a third mortgage over his home from Falco for £30,000 in the hope of clearing the arrears on his prior mortgages. The loan was repayable over a term of twenty-five years at a flat interest rate of 13.99 per cent, with an APR of 19.4 per cent. A concessionary rate of 8.99 per cent was, however, payable unless the mortgage went into arrears, when all future payments would not qualify for the discount. Mr Gough missed the first payment and thus the standard rate become immediately payable. The enforceability of these terms became an issue when Falco applied for possession. The court held that the disparity in the dual interest rate mechanism was unfair under the 1999 Regulations, failing within one of the grey-listed terms.[213] The fact that interest was paid at a flat rate on the whole of the capital, irrespective of any amounts repaid, was also found to be unfair.

QUESTIONS

1. Compare the regulatory regimes established by the Financial Services and Markets Act 2002 and Consumer Credit Act 1974. Which regime do you think is most effective in protecting borrowers?
2. How does a wife prove that her husband has unduly influenced her?
3. When will a bank be 'on notice' that a wife may have been unduly influenced by her husband and what steps should a bank take to minimize this risk?
4. In *Barclays Bank v O'Brien* and *Royal Bank of Scotland v Etridge*, the House of Lords tried to ensure that '*a law designed to protect the vulnerable does not render the matrimonial home unacceptable security to financial institutions*'. Has it succeeded?
5. What is the relationship between undue influence and unconscionable bargains? Would it be helpful to assimilate the two doctrines?
6. Does the clogs and fetters doctrine continue to have any utility?
7. When is a mortgage term 'unfair' within the meaning of the Unfair Terms in Consumer Contract Regulations 1999?
8. What legal controls can a borrower use to challenge the interest that he or she has agreed to pay the lender?

FURTHER READING

Bamford, 'Lord Macnaghten's Puzzle: The Mortgage of Real Property in English Law' [1996] CLP 207

Berg, 'Clogs on the Equity of Redemption: Or Chaining an Unruly Dog' [2002] JBL 335

Bigwood, 'Undue Influence: Impaired Consent or Wicked Exploitation' (1996) 16 OJLS 503

[211] *Wallingford v Mutual Society* (1880) 5 App Cas 685. [212] [1999] CCLR 16.
[213] See Unfair Terms in Consumer Contracts Regulations 1999, Sch 2, para 1(e).

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Birks and Chin, 'On the Nature of Undue Influence' in *Good Faith and Fault in Contract Law* (eds Beatson and Friedmann, Oxford: Clarendon, 1995, ch 3)

Brown, 'The Consumer Credit Act 2006: Real Additional Mortgagor Protection?' [2007] Conv 325

Citizens Advice, *Set Up to Fail: CAB Clients' Experience and Secured Loan Arrears Problems* (2007, available online at http://www.citizensadvice.org.uk)

Devenney, 'A Pack of Unruly Dogs: Unconscionable Bargains, Lawful Act (Economic) Duress and Clogs on the Equity of Redemption' (2002) JBL 539

Deveney and Chandler, 'Unconscionability and the Taxonomy of Undue Influence' [2007] JBL 541

Ferris, 'Why is the Law of Undue Influence So Hard to Understand and Apply?' in *Modern Studies in Property Law: Vol 4* (ed Cooke, Oxford: Hart, 2007)

Nield, 'Borrower as Consumers: New Notions of Unconscionability for the Domestic Borrowers' in *Unconscionability in European Commercial Transactions: Protecting the Vulnerable* (eds Fox, Kenny and Devenney, Cambridge, UK: CUP, 2010).

Nield, 'Responsible Lending and Borrowing: Whereto Low Cost Home Ownership' (2010) 30 LS 610

Whitehouse, A Longitudinal Analysis of the Mortgage Repossession Process 1995–2010: Stability, Regulation and Reform in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011)

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30

LENDER'S RIGHTS AND REMEDIES

CENTRAL ISSUES

1. A lender's rights and remedies arise from the nature of its security, the powers implied by the Law of Property Act 1925, and any express powers. The most important powers are the right to take possession, the power to sell, and the power to appoint a receiver.
2. The lender has an immediate right to take possession, but this right is carefully controlled by equitable duties, procedural safeguards, and, in the case of dwelling houses, legislation.
3. Section 36 of the Administration of Justice Act 1970 enables the court to delay execution of a possession order of a dwelling house if the borrower is able to clear any sums due within a reasonable period either from income or from a sale of the house. This is an important jurisdiction for many homeowners in mortgage arrears.
4. The lender's power of sale is implied by s 101(1)(i) of the 1925 Act and can only be exercised if the borrower has defaulted.
5. The lender is able to sell out of court, but is subject to twin equitable duties: to act in good faith and to take reasonable steps to obtain a proper market price.
6. A lender also has an implied power conferred by s 101(1)(iii) of the 1925 Act to appoint a receiver to collect the income from the property. This power is important in the commercial context, when a receiver may also be granted power to manage and sell the property.

1 INTRODUCTION

We now need to turn our attention to the whole point of the lender taking security—namely, the rights and remedies that security provides if the debt is not repaid. We will concentrate our attention on the most common security over the land: the legal charge by way of mortgage. The most attractive remedy for a lender is the power to sell the land and repay the debt

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from the sale proceeds—but to sell the land most advantageously, the lender will usually wish to sell with vacant possession. Thus, where the land is the borrower's home, the lender will need to evict the borrower and take possession as a prelude to sale. Where the lending is for commercial purposes and the legal charge is over premises that form part of the assets of the business, the lender may prefer to appoint a receiver. A receiver, who is usually a professional insolvency practitioner, has power to collect the income from the premises—for example, the rents from the property portfolio of a business—and to apply that income in the repayment of the debt. A receiver is also usually granted power to manage and sell the land, and any business conducted upon it.

At one time, the ability of a mortgagee to foreclose was an important right. Under a classic mortgage by conveyance, foreclosure operated by barring the borrower's equitable right to redeem to extinguish his or her equity of redemption, so that the lender became the full legal and equitable owner of the property. Under a legal charge by way of mortgage, statutory machinery is required to achieve the same result.[1] But the prospect that the lender could reap a windfall profit where the debt was considerably less than the value of the land led to careful regulation of foreclosure. The lender has to apply to court, which will, as a matter of course, give the borrower a generous time to clear the debt before confirming the foreclosure order.[2] The court also has power to order the sale of the property in preference to foreclosure.[3] Even if a foreclosure order is made, the court may be persuaded to set it aside in certain circumstances.[4]

Given the time, expense, and uncertainty of foreclosure, it is not surprising that it became unpopular and is now effectively obsolete.[5] In this chapter, we will thus concentrate on the right to take possession, and the powers of sale and appointment of a receiver.

1.1 SOURCE OF THE LENDER'S RIGHTS AND REMEDIES

1.1.1 The nature of the security

The lender's rights and remedies will be defined, initially, by the nature of the security itself. A classical mortgage by conveyance or sub-demise gave rise to a right to possession by reason of the legal estate that it conferred upon the lender, whether that was a freehold or a leasehold term. Foreclosure was also an inherent right of a mortgagee by conveyance or sub-demise. A charge, in contrast, gives no inherent right to possession or to foreclose: the chargee at common law must go to court to enforce the charge by obtaining a court order for sale or for the appointment by the court of a receiver. The legal charge by way of mortgage, however, whilst creating a security by way of charge, confers upon the legal chargee the rights and remedies enjoyed by a mortgagee by way of sub-demise for a term of 3,000 years. This is the import of

[1] See Law of Property Act 1925, ss 88(2) and 89(2).

[2] The process involves two stages: the grant of a foreclosure order nisi, requiring accounts to be drawn up detailing exactly what the borrower owes and giving him or her time to repay; and the foreclosure order absolute, which will be made if the borrower has failed to repay as directed.

[3] Law of Property Act 1925, s 91(2).

[4] See *Campbell v Holyland* (1877) 7 Ch D 166. See also the Hong Kong cases of *Hang Seng Bank v Mee Ching Development Ltd* [1970] HKLR 94 and *Frencher Ltd (In liq) v Bank of East Asia* [1995] 2 HKC 263.

[5] The Law Commission has recommended its abolition: Law Commission Report No 204, *Land Mortgages* (1991), [7.27].

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s 87(1) of the Law of Property Act 1925 (LPA 1925).[6] The legal charge by way of mortgage, as a hybrid form of security, thus confers upon the legal chargee the rights and powers enjoyed by a legal mortgagee, including the right to take possession and to foreclose, although its proprietary form is merely a charge.

1.1.2 Powers implied by statute

Section 101 of the LPA 1925 provides another source of the lender's rights and remedies. The section implies into a mortgage made by deed a number of powers, the most important of which are the power to sell and the power to appoint a receiver without, in either case, having to obtain a court order.

Law of Property Act 1925, s 101(1)

Powers incident to estate or interest of mortgagee

(1) A mortgagee, where the mortgage is made by deed, shall by virtue of this Act, have the following powers, to the like extent as if they had been in the terms conferred by the mortgage deed, but not further (namely):

(i) A power, when the mortgage money has become due, to sell, or to concur with any person in selling, the mortgaged property, or any part thereof, either subject to prior charges or not, and either together or in lots, by public auction or by private contract, subject to such conditions respecting title, or evidence of title, or other matter, as the mortgagee thinks fit, with power to vary any contract for sale, and to buy in at an auction, or to rescind any contract for sale, and to re-sell, without being answerable for any loss occasioned thereby;

(ii) [. . .]

(iii) A power, when the mortgage money has become due, to appoint a receiver of the income of the mortgaged property, or any part thereof; or, if the mortgaged property consists of an interest in income, or of a rentcharge or an annual or other periodic sum, a receiver of that property or any part thereof;

[. . .]

A legal charge by way of mortgage, being a legal interest, must be created by deed and will thus enjoy the powers implied by s 101. The powers are implied into second or subsequent legal charges created by deed, although by reason of the rules of priority, a second chargee will only be able to sell subject to the first charge. Alternatively, a second chargee may decide that it is in its interests to take control of any sale of the property, which it can do by paying off the first charge and thus improving its priority position.

Whether or not an equitable mortgagee or chargee will enjoy the statutory powers under s 101 is a little more complicated and turns on the acquisition and content questions relating to equitable security rights that we examined in section 4.3 of Chapter 28. First, the equitable mortgage or charge must be created by deed for s 101 to apply. Secondly, one must look to the property that is expressed to be subject to the security. In *Swift 1st Ltd v Colin*,[7] the

[6] See Chapter 28, section 4.2.

[7] [2011] EWHC 2410 relying on *Re White Rose Cottage* [1965] Ch 940.

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High Court held that a purported legal charge over the whole of the borrower's interest in the property, which took effect only as an equitable charge of the legal estate because it was unregistered,[8] nevertheless conferred power under s 101 to sell the legal and equitable estate. By contrast, an equitable mortgage or a purely equitable charge of a borrower's equitable estate[9] will entitle the equitable mortgagee or chargee to sell only the equitable estate that is the subject of the security. Some further authority, for instance a power of attorney, will be required to sell the borrower's legal estate (if any) in the land.

1.1.3 Express powers

The implied powers of a legal chargee to take possession, to sell, to appoint a receiver, and of foreclose may be excluded, varied, or supplemented by the terms of the security itself.[10] Institutional lenders, like banks and building societies, pay their lawyers to draft a standard set of terms and conditions to be incorporated into their legal charges, which will invariably affect the operation of their implied powers and may grant additional express powers, such as a power to lease. It is thus always important to read the legal charge itself to see how the implied powers may have been altered and what additional express powers have been granted.

1.2 REGULATION OF THE LENDER'S RIGHTS AND REMEDIES

In the last chapter, we saw how the borrower's position can be protected. The borrower is particularly vulnerable where the lender is exercising its rights and remedies—after all, he or she stands to lose his or her home or business.

Equity has long cast a watchful eye over the exercise of the lender's powers to ensure that they are employed only to facilitate recovery of the lender's debt, and then only with due probity and care. A modern expression of this duty is found in the following case.

Palk v Mortgage Service Funding plc
[1993] Ch 330, CA

Sir Donald Nicholls V–C

At 337–8

[. . .] [A] mortgagee can sit back and do nothing. He is not obliged to take steps to realise his security. But if he does take steps to exercise his rights over his security, common law and equity alike have set bounds to the extent to which he can look after himself and ignore the mortgagor's interests. In the exercise of his rights over his security the mortgagee must act fairly towards the mortgagor. His interest in the property has priority over the interest of the mortgagor, and he is entitled to proceed on that footing. He can protect his own interest, but he is not entitled to conduct himself in a way which unfairly prejudices the mortgagor. If he takes possession he might prefer to do nothing and bide his time, waiting indefinitely for an improvement in the market, with the property empty meanwhile. That he cannot do. He is accountable for his actual receipts from the property. He is also accountable to the mortgagor for what he would have received but for his default. So he must take reasonable care to

[8] See Chapter 28, section 4.3.1. [9] See Chapter 28, sections 4.3.2 and 4.3.3.
[10] See, in relation to the s 101 powers, s 101(3)–(4). As to the relationship between the expressed and implied powers, see *Horsham Properties Group Ltd v Clark* [2008] EWHC 2327.

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maximise his return from the property. He must also take reasonable care of the property. Similarly if he sells the property: he cannot sell hastily at a knock-down price sufficient to pay off his debt. The mortgagor also has an interest in the property and is under a personal liability for the shortfall. The mortgagee must keep that in mind. He must exercise reasonable care to sell only at the proper market value. As Lord Moulton said in *McHugh v. Union Bank of Canada* [1913] A.C. 299, 311: "It is well settled law that it is the duty of a mortgagee when realising the mortgaged property by sale to behave in conducting such realisation as a reasonable man would behave in the realisation of his own property, so that the mortgagor may receive credit for the fair value of the property sold."

Parliament has also intervened, but only where the lender is seeking possession of a dwelling house by obtaining a court order for possession.[11] The county court has primary jurisdiction, which provides a more informal venue for such intimidating proceedings. More significantly, the court is given discretion to halt the progress of the proceedings to allow the borrower time to try to pay any arrears or remedy any other default.

Market regulation, through the Financial Services and Market Act 2000 (FSMA 2000) and the Consumer Credit Act 1974 as amended (CCA 1974), also plays its part in trying to ensure that lenders treat borrowers in default fairly. We considered the impact of this legislation in Chapter 29 (see section 3). Most first legal mortgages, secured upon an individual borrower's home, are regulated under the FSMA 2000, with rules in the Mortgage Conduct of Business Sourcebook (MCOB)[12] setting standards on the handling of arrears.

FSA Handbook, Arrears and repossessions: regulated mortgage contracts and home purchase plans (MCOB 13)

MCOB 13.3 Dealing fairly with customers in arrears: policy and procedures

MCOB 13.3.1

1. A firm must deal fairly with any customer who:
   (a) is in arrears on a regulated mortgage contract or home purchase plan;
   (b) has a sale shortfall; or
   (c) is otherwise in breach of a home purchase plan.
2. A firm must put in place, and operate in accordance with, a written policy (agreed by its respective governing body) and procedures for complying with (1). Such policy and procedures must reflect the requirements of MCOB 13.3.2AR and MCOB 13.3.4AR.

MCOB 13.3.2A

A firm must when dealing with any customer in payment difficulties:

1. make reasonable efforts to reach an agreement with a customer over the method of repaying any payment shortfall or sale shortfall, in the case of the former having regard to the desirability of agreeing with the customer an alternative to taking possession of the property;

[11] See Administration of Justice Act 1970 (as amended), s 36, see section 2.5 below.
[12] Part of the Financial Services Authority (FSA) Handbook.

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2. liaise, if the customer makes arrangements for this, with a third party source of advice regarding the payment shortfall or sale shortfall;
3. allow a reasonable time over which the payment shortfall or sale shortfall should be repaid, having particular regard to the need to establish, where feasible, a payment plan which is practical in terms of the circumstances of the customer;
4. grant, unless it has good reason not to do so, a customer's request for a change to:
   (a) the date on which the payment is due (providing it is within the same payment period); or
   (b) the method by which payment is made;
   and give the customer a written explanation of its reasons if it refuses the request;
5. where no reasonable payment arrangement can be made, allow the customer to remain in possession for a reasonable period to effect a sale; and
6. not repossess the property unless all other reasonable attempts to resolve the position have failed.

MCOB 13.3.3A

In complying with MCOB 13.3.2A a firm must give a customer a reasonable period of time to consider any proposals for dealing with the payment difficulties.

MCOB 13.3.4A

1. a firm must consider whether, given the individual circumstances of the customer, it is appropriate to do one or more of the following in relation to the regulated mortgage contract or home purchase plan with the agreement of the customer:
   (a) extend its term; or
   (b) change its type; or
   (c) defer payment of interest due on the regulated mortgage contract or of sums due under the home purchase plan (including, in either case, on any sale shortfall); or
   (d) treat the payment shortfall as if it was part of the original amount provided (but a firm must not automatically capitalise a payment shortfall); or;
   (e) make use of any Government forbearance initiatives in which the firm chooses to participate.
2. a firm must give customers adequate information to understand the implications of any proposed arrangement; one approach may be to provide information on the new terms in line with the annual statement provisions.

MCOB 13.3.4B

A firm must make customers aware of the existence of any applicable Government schemes to assist borrowers in payment difficulties in relation to regulated mortgage contracts.

Similar calls for forbearance and to seek repossession as a last resort are found in the OFT Guidance to Creditors on Irresponsible Lending[13] and Second Charge Lending, when the mortgage or charge is subject to the CCA 1974.[14] Furthermore, enforcement practices by

[13] OFT 1107 (March 2010).
[14] OFT1105 (July 2009). See also OFT, Consultation on Debt Collection OFT 664con (March 2011) .

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lenders governed by the CCA 1974 may also be scrutinized under the unfair relationship test found in s 140A–C.[15]

A Pre-action Protocol on Possession Actions based upon Mortgage Arrears has been introduced by the Civil Justice Council.[16] This protocol reflects MCOB 13 but affects all court sanctioned repossessions of dwelling houses whether or not regulated by FSMA 2000 or the CCA 1974. It operates by requiring scrutiny at court level to try and ensure that lenders do not resort to immediate repossession before having taken steps (where appropriate) to reschedule the borrower's indebtedness or otherwise resolve the borrower's repayment difficulties.[17]

The guiding principle is thus for lenders to try to agree with their defaulting borrowers a way of clearing arrears by rescheduling repayments, rather than resorting to immediate legal redress. A rise in the rate of repossessions, following the credit crunch led to the early implementation of the Pre-action Protocol and increased pressure on lenders to comply with these regulatory standards and show forbearance. These measures appeared to be having some effect with repossessions falling short of predicted levels. [18]

The fears of a surge in repossessions triggered by the credit crunch also led the Government to introduce a Mortgage Rescue Scheme and a Mortgage Support Scheme. The Mortgage Rescue Scheme provides a last resort for particularly vulnerable homeowners to stay in their home even though their mortgage commitments have become unsustainable. It does so by facilitating the sale of the borrower's home to a registered social landlord who then leases back the home to the borrower on a secure tenancy. The Mortgage Support Scheme provided a limited Government guarantee to those lenders who agreed to reschedule the borrower's debt, but the scheme proved unpopular and was short lived.[19]

The private sector has also seen a growth in sale and leaseback schemes which can appear attractive to financially distressed borrowers wishing to stay in their homes. A privately negotiated sale of the mortgaged home is agreed at a discount of its market price. The purchaser pays off the mortgage and arrears and then leases the home back to the borrower/tenant under a short-term tenancy, which offers little security of tenure. The inequality between the purchaser/landlord and the borrower/tenant is obvious and after calls by the OFT these schemes became subject to FSA regulation from 1 July 2009 with tighter rules introduced with effect from 30 June 2010.[20] Certain sale and leaseback arrangements have also been subject to legal challenge.[21]

[15] OFT, Unfair Relationships and Enforcement Action under Part 8 Enterprise Act OFT 859Rev (May 2008 updated August 2011). See Chapter 29, section 3.2.3.

[16] Available online at http://www.civiljusticecouncil.gov.uk. The Protocol was implemented earlier than planned on 19 November 2008.

[17] Whitehouse, 'The mortgage arrears pre-action protocol: an opportunity missed' (2009) 72 MLR 793.

[18] Ford and Wallace, *Uncharted Territory? Managing arrears and possessions,* (Shelter, 2009); Wallace and Ford, 'Limiting possessions? Managing mortgage arrears in a new era' (2010) 10 JIHP 133; Whitehouse, 'Longitudinal Analysis of the Mortgage Repossession Process 1995–2010: Stability, Regulation and Reform' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2010) ch 7. Previous research had shown variable compliance with MCOB 13 see Citizens Advice, *Set Up To Fail: CAB Client's Experience of Mortgage and Secured Loan Arrears Problems* (2002); FSA, *Mortgage Effectiveness Review Arrears Findings* (2008).

[19] Ford and Wallace, *Unchartered Territory: Managing mortgage arrears and possessions* (Shelter, 2009) p 33 and Wilcox, Wallace, Bramley, Morgan, Sosenko, and Ford, An Evaluation of Mortgage Rescue Scheme and Homeowners Mortgage Support Interim Report DCLG (July 2010).

[20] For example, independent sales valuations, affordability and benefit checks, minimum lease terms and cooling off periods. See Marston and Wilding, 'Credit crunch, housing benefit and sale and rent back agreements' [2009] Conv 413.

[21] See *UK Housing Alliance (North West) Ltd v Francis* [2010] EWCA Civ 117 where, although subject to UTCCR, the terms were found fair and *Re North East Property Buyers Litigation* [2012] EWCA Civ 17 where the borrower/tenants failed to establish that their interests were overriding.

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2 POSSESSION

2.1 THE STARTING POINT: AN IMMEDIATE RIGHT TO POSSESSION

A legal chargee of land is entitled to take possession of the charged property. This right arises because a legal chargee is entitled to the rights of a mortgagee by way of sub-demise who enjoys a right to immediate possession by reason of the leasehold term.[22] This right to possession is thus not dependent upon default.

Harman J made the point forcibly in a number of decisions—most infamously, in the following case.[23]

Four-Maids Ltd v Dudley Marshall (Properties) Ltd
[1957] Ch 317, HC

Harman J

At 320

I repeat now, that the right of the mortgagee to possession in the absence of some contract has nothing to do with default on the part of the mortgagor. The mortgagee may go into possession before the ink is dry on the mortgage unless there is something in the contract, express or by implication, whereby he has contracted himself out of that right. He has the right because he has a legal term of years in the property or its statutory equivalent [. . .] If there is a provision that, so long as certain payments are made, he will not go into possession, then he has contracted himself out of his rights. Apart from that, possession is a matter of course.

Even equity will not intervene, beyond granting a short adjournment to allow the borrower to redeem the whole loan. Arguments suggesting that there was such an equitable jurisdiction were soundly rejected in the following case.

Birmingham Citizens Permanent Building Society v Caunt
[1962] Ch 883, HC

Russell J

At 896

For the building society it was contended that the argument based on the equity of redemption and the tenor of the mortgage was novel and fundamentally unsound. Equity had always interfered with legal rights in order to ensure that the mortgage should not operate otherwise than as it was intended to operate—namely, as security for repayment of money. But there was no principle upon which equity had ever attempted or could ever rightly attempt to interfere with the security *as a security,* or to destroy or suspend or nullify any rights of the

[22] See Law of Property Act 1925, s 87(1). The right is unaffected by the grant of a subcharge: see *Credit and Mercantile plc v Marks* [2004] EWCA Civ 568, [2005] Ch 81.

[23] See also *Alliance Perpetual Building Society v Belrum Investments Ltd* [1957] 1 WLR 720; *Hughes v Waite* [1957] 1 WLR 713.

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> mortgagee which were part and parcel of that security. The whole purpose of equity was, by insisting that the transaction was a security for the repayment of money, thereby to shield the mortgagor from attempts in reliance on strict legal rights to turn it into something more. Equity was never and should never be in the hands of the judges a sword to attack any part of the security itself, and the right to possession was an important part of that security, more particularly in the association with the ability to give vacant possession on the exercise of the power of sale. These appear to me to be sound answers to an attempt to give reasons for the existence of a jurisdiction such as is suggested. I think there was and is no such jurisdiction.

This fundamental principle also leads to the conclusion that the existence of a counterclaim or equitable right of set-off—by which the borrower might be able to argue that, at the end of the day, he or she owes no money to the lender—does not detract from the lender's immediate right to possession.[24]

2.2 THE EQUITABLE DUTY TO ACCOUNT

Equity will not interfere with the lender's right to take possession, but it will control the exercise of that right. Where the property is let and the lender goes into possession by collecting the rents, it must apply the rent in the discharge of the debt. Furthermore, it is under a duty to account not only for the income received, but also the income that should have been received *but for* the lender's wilful default.[25]

Frisby has examined a mortgagee's duty to account following its application to receivers in *Medforth v Blake*.[26]

Frisby, 'Making a Silk Purse Out of a Pig's Ear: *Medforth v Blake & Ors*' (2000) 63 MLR 413, 416

> Liability to account for wilful default is of ancient origin arising out of the account jurisdiction of the Courts of Equity. On a suit for redemption a Chancery Master took an account, whereby the mortgagee's principal, interest and costs were set against the amount received from the mortgaged property. Where the mortgagee had previously taken possession, this last item included not only what *had been* received but what *might have been* received but for his wilful default. Thus equity's traditional protective stance towards the mortgagor's equity of redemption was manifest by the imposition of 'almost penal liabilities.'
>
> Whilst the basic principle of wilful default liability is easily stated, its content is less readily identifiable. Some cases ascribe liability to stated misconduct without further comment. These 'factual instances' of wilful default include refusal to accept tenants and the disadvantageous letting of property. Permitting a mortgagor to intercept 'profits' or failing to receive the purchase price on a sale of the mortgaged property similarly attracted liability. The courts showed varying degrees of strictness in this regard.

[24] See *Samuel Keller Holdings Ltd v Martins Bank Ltd* [1971] 1 WLR 43; *Mobil Oil Co Ltd v Rawlinson* (1982) 43 P & CR 221; *Citibank Trust Ltd v Ayivor* [1987] 1 WLR 1157; *National Westminster Bank Plc v Skelton* [1993] 1 WLR 72; *Ashley Guarantee v Zacaria* [1993] 1 WLR 62.

[25] *White v City of London Brewery* (1889) 42 Ch D 237. For a consideration for 'wilful default', see Stannard (1979) Conv 345.

[26] [1999] 3 All ER 97, considered further at section 4.3 below.

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These illustrations of liability give little guidance as to whether wilful default requires deliberate, reckless or simply unthinking conduct, the brevity of the reports making it difficult to discern whether the penalised behaviour was collusive or careless. Attempts to extract a governing principle that might predict liability for wilful default exhibit a subtle shift in emphasis from liability to duty. For example, the notion that a mortgagor owes a duty of diligence was propounded by Turner LJ in *Sherwin v Shakspear*.

Other authorities treat wilful default as established by a particular degree of dereliction. In *ex parte Mure* Thurlow LC contemplated that involuntary conduct might suffice to ground liability, although on the facts the negligence was 'gross'. Later cases tend to support the proposition that the carelessness in question may be less than fraud but more than mere negligence. If gross negligence and ordinary diligence exact differing standards of conduct, which is to be preferred? It is not immediately obvious that any of the above cases is conclusively authoritative, especially since many judicial statements in this regard appear to be mere *dicta,* and Stannard concludes that 'wilful default' is purely a relative term, meaning no more than a failure to perform a duty.

Whilst the older authorities may be unclear as to the degree of default, more recent authorities tend to support the view that a mortgagee's conduct should be tested according to standards of reasonableness. This was the test applied to receivers in *Medforth v Blake*, which also finds expression in the passage from *Palk* extracted at section 1.2 above.

Whatever the exact standard may be, these duties are usually perceived as sufficiently onerous to deter a lender from taking possession, except for a short time as a prelude to sale. As we shall see, a lender can avoid personal liability where it appoints a receiver, which is the preferred course of action where the lender anticipates taking possession for an extended period.

2.3 THE PURPOSE OF TAKING POSSESSION

In the following case, a house had been let to students whom the landlord wanted to evict—but he could not do so, because their tenancy was protected by legislation. The mortgage of the house prohibited letting without the consent of the bank, which the landlord had failed to obtain. The landlord was thus in breach of the mortgage, but the bank refused the landlord's request to exercise its right to take possession and evict the students. As an alternative ploy, the landlord arranged for his wife to take a transfer of the mortgage, so that she could exercise the right of the mortgagee to evict the students. The Court of Appeal refused to grant an order for possession, although the judges differed in their reasoning.

Quennell v Maltby
[1979] 1 WLR 318, CA

Lord Denning MR

At 322

So here in modern times equity can step in so as to prevent a mortgagee, or a transferee from him, from getting possession of a house contrary to the justice of the case. A mortgagee will be restrained from getting possession except when it is sought bona fide and reasonably for the purpose of enforcing the security and then only subject to such conditions as the court thinks fit to impose. When the bank itself or a building society lends the money, then it may

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well be right to allow the mortgagee to obtain possession when the borrower is in default. But so long as the interest is paid and there is nothing outstanding, equity has ample power to restrain any unjust use of the right to possession.

The other members of the Court of Appeal agreed with the result, but based their reasoning upon a narrower premise. Lord Templeman stated:[27] '*The estate, rights and powers of a mortgagee* [...] *are only vested in a mortgagee to protect his position as a mortgagee and to enable him to obtain repayment.*'

The width of Lord Denning's views was criticized at the time,[28] but has subsequently been cited with approval.[29] The decision does give expression to equity's underlying concern that lenders exercise their rights bona fide for the purpose of recovering the debt due to them and not for some other purpose—a proposition that was repeated by Lord Templeman as a member of the Privy Council in *Downsview Nominees Ltd v First City Corporation Ltd*.[30]

2.4 PROCEDURAL SAFEGUARDS

Those who take it upon themselves to evict occupiers from their property face criminal sanctions and this legislation applies to lenders as to anyone else. By s 6 of the Criminal Law Act 1977, it is an offence to use violence to gain possession of occupied premises, whilst by s 1(3) of the Protection from Eviction Act 1977, it is an offence to harass an occupier of residential premises to 'persuade' him or her to give up occupation. Invariably, therefore, lenders will seek the assistance of the court to gain entry to premises that are occupied. It is only where premises are empty, or where the borrower voluntarily gives up possession, that the lender will risk entering otherwise than by executing an order for possession.

Taking possession of a borrower's home is a particularly sensitive issue, and mortgages regulated by the FSMA 2000 and CCA 1974 are subject to additional safeguards. The CCA 1974 requires notice of arrears to be served upon the borrower,[31] and for possession to be obtained by court order.[32] We have already considered the regulatory pressures upon CCA and FSMA lenders to come to some arrangement with the borrower to clear any arrears and to only seek repossession as a last resort. The Pre-action Protocol on Repossessions based upon Mortgage Arrears reinforces these standards.[33]

2.5 DWELLING HOUSES AND S 36 OF THE ADMINISTRATION OF JUSTICE ACT 1970 (AS AMENDED)

The decision in *Caunt* (see section 2.1 above) led to a need to rethink the exercise of the lender's immediate right to possession in respect of residential property.[34] The result is s 36 of the Administration of Justice Act 1970.

[27] At 324. [28] Smith [1979] Conv 266; Pearce [1979] CLJ 257.

[29] See *Albany Home Loans Ltd v Massey* (1997) 37 P & CR 509, 513, in which the court refused an order for possession against a husband when to do so would have been futile, because his wife, who was not bound by the mortgage, was entitled to remain in possession as a joint tenant.

[30] [1993] AC 295, 312. [31] Consumer Credit Act 1974 (as amended), ss 76, 86B–86E, 87, and 88.

[32] Ibid, s 126. [33] See section 1.2 above.

[34] See the Payne Committee Report (Cmnd 3909, 1969); Haley, 'Mortgage Default: Possession, Relief and Judicial Discretion' (1997) 17 LS 483.

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Administration of Justice Act 1970, s 36

Additional powers of court in action by mortgagee for possession of dwelling-house

1. Where the mortgagee under a mortgage of land which consists of or includes a dwelling-house brings an action in which he claims possession of the mortgaged property, not being an action for foreclosure in which a claim for possession of the mortgaged property is also made, the court may exercise any of the powers conferred on it by subsection (2) below if it appears to the court that in the event of its exercising the power the mortgagor is likely to be able within a reasonable period to pay any sums due under the mortgage or to remedy a default consisting of a breach of any other obligation arising under or by virtue of the mortgage.

2. The court—

   (a) may adjourn the proceedings, or

   (b) on giving judgment, or making an order, for delivery of possession of the mortgaged property, or at any time before the execution of such judgment or order, may—

      (i) stay or suspend execution of the judgment or order, or

      (ii) postpone the date for delivery of possession,

   for such period or periods as the court thinks reasonable.

3. Any such adjournment, stay, suspension or postponement as is referred to in subsection (2) above may be made subject to such conditions with regard to payment by the mortgagor of any sum secured by the mortgage or the remedying of any default as the court thinks fit.

4. The court may from time to time vary or revoke any condition imposed by virtue of this section.

The section does not limit the lender's inherent right to take possession, but it does control its exercise by conferring upon the court power to adjourn proceedings, or to stay or postpone execution of the order for possession. The court cannot give an indefinite period of suspension, but it can extend the stay upon the borrower making a further application.[35] The court will thus grant the order for possession, but may not allow the lender to ask the bailiff to execute the order. The motive is to allow the borrower time to repay the sums owing, or at least any arrears. Unfortunately for such a significant jurisdiction, s 36 is not the most happily worded and has raised a number of problems of interpretation, as well as calls for reform.[36]

It should also be noted that, where a mortgage is regulated by the CCA 1974, the court enjoys an additional discretion to grant a time order to extend the time for enforcement of the lender's right to possession,[37] and, in such circumstances, to amend and vary the mortgage terms as it see fit.[38] Because consumer credit regulation affects second mortgagees, who are unlikely to be able to exercise their right to possession in priority to the first chargee, this jurisdiction is less significant than s 36.

[35] *Royal Trust Co of Canada v Markham* [1975] 1 WLR 1416, 1424.

[36] See Smith [1979] Conv 266; Haley, 'Mortgage Default: Possession, Relief and Judicial Discretion' (1997) 17 LS 483.

[37] Consumer Credit Act 1974 (as amended), ss 129 and 130.

[38] Ibid, s 136. See McMurtry, 'Consumer Credit Act Mortgages: unfair terms, time orders and judicial discretion' [2010] JBL 107.

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2.5.1 'Dwelling-house'

Needless to say there have been questions over what constitutes a 'dwelling-house'. It does not matter if only part of the property is a dwelling, or that the dwelling house is not the borrower's home.[39] The protection is thus not restricted to the residential lending market, but can catch commercial lending where the security includes a dwelling house. The time for determining whether or not the security is over, or includes, a dwelling house is the time of the order for possession, rather than the time of the mortgage itself.[40]

2.5.2 Court proceedings for possession

The more difficult question is whether the court's jurisdiction is only available where the lender has applied for an order for possession. We have noted that the lender will invariably do so where the borrower is in residence, but what about when the borrower, for one reason or another, is not?

Just such a situation arose in the following case, in which the Court of Appeal—taking a literal, rather than a purposive, approach to interpretation of s 36—held that it had no application where a lender was not seeking an order for possession.

Ropaigealach v Barclays Bank plc
[2000] QB 263, CA

Facts: The Ropaigealachs fell into mortgage arrears and their lender, Barclays, wrote to them, making a final demand for payment and warning them that their property would be sold. The Ropaigealachs did not receive the letter, because they were not living at the property whilst it was being renovated, and did not hear of the sale until told by a neighbour. The Court declined to grant a declaration that Barclays was not entitled to take possession and sell without obtaining a court order.

Clarke LJ

At 283

It is true to say that neither this court in *Caunt's case* nor the Payne Committee was considering whether the court should have similar powers in cases in which the mortgagee chooses not to take proceedings for possession but simply takes possession or perhaps sells the property under his power of sale and the purchaser takes possession. In these circumstances I agree that it cannot readily be inferred that Parliament intended to give protection to mortgagors in such a case. It does however strike me as very curious that mortgagors should only have protection in the case where the mortgagee chooses to take legal proceedings and not in the case where he chooses simply to enter the property. As Alison Clarke put it in her illuminating article "Further implications of section 36 of the Administration of Justice Act 1970" in *The Conveyancer & Property Lawyer* (1983), p. 293, [...] it is anomalous and undesirable to protect mortgagors against eviction by court process yet leave them open to eviction by self-help.

[39] See *Bank of Scotland v Miller* [2001] EWCA Civ 344, [2002] QB 255, in which the property was a nightclub with an unoccupied flat above.

[40] Ibid.

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> The second case which seems to me to highlight the potential problems is the decision of this court in *National & Provincial Building Society v. Ahmed* [1995] 2 E.G.L.R. 127, where it was held that the mortgagor's equity of redemption is extinguished when the mortgagee, in the exercise of his power of sale, enters into a contract of sale of the mortgaged property [. . .]
>
> In a Law Commission Working Paper No. 99 on *Land Mortgages* (1986), which was produced before the report and was expressly stated not to represent the final views of the Commission, the position was put thus with regard to the court's discretion under section 36, at p. 103, para. 3.69:
>
> > "(b) The discretion is to delay or withhold the possession order only, not any other remedy. In practice this usually prevents enforcement, but in theory it is still open to the mortgagee to proceed to exercise its power of sale notwithstanding the court's refusal to make a possession order. Since such a sale terminates the mortgagor's interest in the property, the purchaser presumably would have no difficulty in obtaining a possession order against the mortgagor after completion."
>
> In a written note sent to us after the conclusion of the hearing Miss Gloster says that the bank would not go so far as to submit that that view is correct. Miss Gloster correctly adds that this kind of issue does not to fall for determination on this appeal, and I express no view upon the solution to such problems, but such considerations do highlight the potential problems. Such problems would not arise (or would be much reduced) if it were held that the effect of section 36 were [. . .] to give the court the same power to inhibit the exercise by the mortgagee of its right to possession at common law whether it were exercised by simply entering possession or by doing so pursuant to an order of the court [. . .]
>
> It seems to me that if a mortgagor needs that relief he needs it whether the mortgagee chooses to exercise his right of possession by entering into possession with or without an order of the court. Indeed he also needs it if instead of doing either the mortgagee sells the property to a purchaser leaving the purchaser to take possession.
>
> I recognise that Miss Gloster says that responsible mortgagees do not in practice take possession of property in which the mortgagor and his family are living without an order of the court, and I accept that that is so, but in my judgment the problem should be approached by reference to the legal rights of the mortgagee and to the legitimate interests of the mortgagor in the light of the purpose of the Act. In these circumstances, if it were possible to construe section 36 by affording mortgagors protection whether or not the mortgagee chose to obtain possession by self-help or legal action, I for my part would do so. I have however been persuaded that it is not possible.

Clarke LJ refers also to the situation in which a lender exercises its power of sale without having first obtained possession. In these circumstances, the sale will overreach the borrower's equity of redemption and pass an unencumbered title to the purchaser.[41] But if the property is occupied (e.g. by the borrower or his or her tenant), the suggestion made by Millett LJ in *National & Provincial Building Society v Ahmed*[42] is that s 36 will again come into play if the purchaser seeks an order for possession, although, given that the borrower's interests will have been overreached, it is difficult to see how he or she could resist a purchaser's application for possession. Indeed, this was the approach taken by the High Court in *Horsham Properties Group Ltd v Clark*.[43] If a purchaser can be found to purchase the property whilst the borrower is still in occupation, there is thus a worrying route by which s 36 can be avoided.

[41] Law of Property Act 1925, ss 88(1) and s 89(1).

[42] [1995] 2 EGLR 127; *Duke v Robson* [1973] 1 WLR 267.

[43] [2008] EWHC 2327.

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2.5.3 Who needs to be told of possession proceedings and who can apply under s 36?

Possession proceedings will be issued against the borrower(s), as mortgagor(s), who can apply for relief under s 36.[44] The Civil Procedure Rules now require the lender to send notice of possession proceedings to the property so that a tenant or other occupier should hopefully also be aware of the proceedings.[45]

Two common situations need to be considered further. First, a borrower as mortgagor may hold the dwelling house on trust for themselves and their spouse or partner as equitable co-owners, or that spouse or partner may have a statutory right of occupation. We considered how these situations may arise in Chapter 16. Such a spouse or partner may not be a party to the mortgage and possession proceedings may not be directly issued against them. However, where they do learn of the possession proceedings, he or she may apply to court to be joined as a party and seek the relief afforded by s 36.[46]

Secondly, is the position of a tenant of the borrower. Where the tenancy is authorized by the lender it will be binding upon him and the lender cannot obtain possession unless entitled to do so under the terms of the tenancy. Although, as we will see in section 4 below, he or she may appoint a receiver to collect the rental income or sell the property subject to the tenancy. Where the tenancy is unauthorized by the lender the tenancy is not binding on the lender and the unauthorized tenant may be evicted by the lender. The unauthorized tenant may not apply under s 36[47] but limited protection against immediate eviction is now available under Mortgage Repossession (Protection of Tenant etc) Act 2010.[48] An unauthorized tenant may apply, either on the application for the possession order or its execution, for a stay of delivery of possession for a period for two months in order to give a breathing space to find alternative accommodation. The court in exercising its discretion whether or not to accede to the tenant's application must have regard to his or her circumstances and whether or not there is an outstanding breach of the tenancy agreement. The court may also order the tenant to pay their rent directly to the lender.

2.5.4 The court's discretion

The court may exercise its jurisdiction where it is satisfied that the borrower is likely to be able, within a reasonable period, to pay any sums due under the mortgage or to remedy any other default.[49] The vast majority of cases are concerned with mortgage arrears, when the court is solely concerned with how and when the borrower is able to meet his or her financial commitments.[50]

[44] A purchaser from the borrower who takes subject to the mortgage may also apply AJA, s 39(1).

[45] Civil Procedure Rules Pt 55 Rule 10(2). See also s 56 Family law Act 1996 which requires a lender to serve notice of proceedings upon a spouse who has registered his or her statutory right of occupation.

[46] In the case of an equitable co-owner because they fall within the definition of a mortgagor under s 36 see *Cheval Bridging Finance Ltd v Bhasin* [2008] EWCA Civ 1613 and in the case a spouse with a statutory right of occupation see Family Law Act 1996, s 55(2).

[47] *Britannia Building Society v Earl* [1990] 1 WLR 422, 430.

[48] See O'Neill, 'The Mortgage Repossession (Protection of Tenants etc) Act 2010—Sufficient protection for tenants?' [2011] Conv 380.

[49] For example, in the case of breach of a covenant against letting by removing the tenants: see *Britannia Building Society v Earl* [1990] 1 WLR 422, 430. It should be noted that the jurisdiction is available even though there has been no default see *Western Bank Ltd v Schindler* [1977] Ch 1.

[50] Compare Trusts of Land and Appointment of Trustees Act 1996, ss 14 and 15 (see Chapter 18, section 5.5), where a mortgagee is applying for the sale of co-owner's interest in land.

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What sums are due under the mortgage?

Initially, there is the question of what sums are due under the mortgage where an acceleration provision in the mortgage operates on default to trigger repayment of all sums secured under the mortgage, including the full capital value of the loan and any outstanding interest. In *Halifax Building Society v Clark*,[51] the court held that it was, indeed, the total of these sums that the borrower was required to clear. The purpose of s 36 was accordingly placed in jeopardy: if the borrower was already unable to meet his or her periodic repayments, he or she was hardly likely to be able to repay the whole loan.

Parliament was swift to react to restrict the meaning of 'sums due' to any arrears.

Administration of Justice Act 1973, s 8

1. Where by a mortgage of land which consists of or includes a dwelling-house, or by any agreement between the mortgagee under such a mortgage and the mortgagor, the mortgagor is entitled or is to be permitted to pay the principal sum secured by instalments or otherwise to defer payment of it in whole or in part, but provision is also made for earlier payment in the event of any default by the mortgagor or of a demand by the mortgagee or otherwise, then for purposes of section 36 of the Administration of Justice Act 1970 (under which a court has power to delay giving a mortgagee possession of the mortgaged property so as to allow the mortgagor a reasonable time to pay any sums due under the mortgage) a court may treat as due under the mortgage on account of the principal sum secured and of interest on it only such amounts as the mortgagor would have expected to be required to pay if there had been no such provision for earlier payment.

2. A court shall not exercise by virtue of subsection (1) above the powers conferred by section 36 of the Administration of Justice Act 1970 unless it appears to the court not only that the mortgagor is likely to be able within a reasonable period to pay any amounts regarded (in accordance with subsection (1) above) as due on account of the principal sum secured, together with the interest on those amounts, but also that he is likely to be able by the end of that period to pay any further amounts that he would have expected to be required to pay by then on account of that sum and of interest on it if there had been no such provision as is referred to in subsection (1) above for earlier payment.

Section 8 brought its own problems of interpretation, in the shape of what type of loan repayment scheme fell within its terms. Clearly, the standard repayment mortgage, whereby instalments of capital and interest are repaid over a fixed term, are covered.[52] The court has held that endowment mortgages are similarly included,[53] but mortgages repayable on demand, which are common to secure an overdraft facility granted to provide funds to the borrower's business, do not fall within s 8.[54]

[51] [1973] Ch 307.

[52] *Centrax Trustees v Ross* [1979] 2 All ER 952.

[53] *Bank of Scotland v Grimes* [1986] QB1179. Under an endowment mortgage, the borrower's instalment payments meet only the interest payable. The borrower also pays periodic insurance premiums to maintain an endowment policy that, at the end of the mortgage term, will mature to produce a lump sum, which should be sufficient to repay the capital advanced.

[54] *Habib Bank Ltd v Tailor* [1982] 1 WLR 1218; *Rees Investment Ltd v Groves* [2002] 1 P & CR DG 9.

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What is a 'reasonable period'?

The significance of s 8 has diminished somewhat as a result of the interpretation that the courts have accorded to what is a 'reasonable period' in which repayment is to be made. It is clear that the Payne Committee and Parliament envisaged a relatively short period, of a year or two, to provide the borrower with relief, so that he or she could overcome a temporary financial setback, such as the loss of a job, or an illness. The Court of Appeal, in the light of the property slump of the early 1990s during which mortgage repossessions soared, adopted a different approach.

Cheltenham & Gloucester Building Society v Norgan
[1996] 1 WLR 343, CA

Facts: Mrs Norgan had borrowed £90,000, repayable by monthly instalments over twenty-two years, with the loan being secured upon her farmhouse. She fell into arrears, and the Cheltenham & Gloucester obtained a possession order, which was stayed on several occasions. The arrears remained substantial, and the Cheltenham & Gloucester applied again to execute the possession order.

Waite LJ

At 353

In the present plight of the housing market possession cases play a major part in the caseload for the county courts. That is particularly true of the district judges, who deal with those cases in such numbers that they develop a "feel" for them and have achieved an excellent disposal record. It is not surprising that they have found it convenient to adopt a relatively short period of years as the rough rule of thumb which aids a just determination of the "reasonable period" for the purposes of section 36 of the Act of 1970 and section 8 of the Act of 1973. Nevertheless, although I would not go quite so far with Mr. Croally as to say it should be an "assumption," it does seem to me that the logic and spirit of the legislation require, especially in cases where the parties are proceeding under arrangements such as those reflected in the C.M.L. statement, that the court should take as its starting point the full term of the mortgage and pose at the outset the question: "Would it be possible for the mortgagor to maintain payment-off of the arrears by instalments over that period?"

I accept all the grounds urged on us by Mr. Waters for saying that the dicta relied on in *First Middlesbrough Trading and Mortgage Co. Ltd. v. Cunningham* (1974) 28 P. & C.R. 69 and *Western Bank Ltd. v. Schindler* [1977] Ch.1 were directed to situations different from the circumstances of this case and most other cases of its kind, but they nevertheless in my judgment provide confirmation of the view that such is the right approach. I would acknowledge, also, that this approach will be liable to demand a more detailed analysis of present figures and future projections than it may have been customary for the courts to undertake until now. There is likely to be a greater need to require of mortgagors that they should furnish the court with a detailed "budget" of the kind that has been supplied by the mortgagor in her affidavit in the present case. But analysis of such budgets is part of the expertise in which the district judges have already become adept in their family jurisdiction and I would not expect that to present too great a difficulty. There will be instances, too, in which preliminary adjudication will be necessary to determine, when calculating the amount of arrears and assessing the future instalments for their payment-off, which items are to be attributed to the mortgagor's current payment obligations and which to his ultimate liability on capital account. The present

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case has shown—through the disparity introduced by the disputed items—how problematic that may sometimes prove to be. They are nevertheless disputes that it will be essential to resolve—in this case and others where they arise—before the court can undertake an accurate estimate of the amount which the mortgagor would be required to meet if the arrears were to be made repayable over the full remainder of the mortgage term. There may also be cases, as Mr. Waters points out, in which it is less obvious than in this case that the mortgagee is adequately secured—and detailed evidence, if necessary by experts, may be required to see if and when the lender's security will become liable to be put at risk as a result of imposing postponement of payments in arrear. Problems such as these—which I suspect will arise only rarely in practice although they will undeniably be daunting when they do arise—should not however be allowed, in my judgment, to stand in the way of giving effect to the clearly intended scheme of the legislation.

There is another factor which, to my mind, weighs strongly in favour of adopting the full term of the mortgage as the starting point for calculating a "reasonable period" for payment of arrears. It is prompted by experience in this very case. The parties have been before the court with depressing frequency over the years on applications to enforce, or further to suspend, the warrant of possession, while Mrs. Norgan and her husband have struggled, sometimes with success and sometimes without, to meet whatever commitment was currently approved by the court. Cheltenham has (in exercise of its power to do so under the terms of the mortgage) added to its security the costs it has incurred in connection with all these attendances. One of the disputed items turns upon the question whether such costs fall to be allocated to capital or to interest account. What is not in dispute, however, is that one day, be it sooner or later, those costs will have to be borne by the mortgagor, and if the day comes when she decides—or is compelled by circumstances—to move to more readily affordable accommodation, her resources for rehousing will be correspondingly reduced. It is an experience which brings home the disadvantages which both lender and borrower are liable to suffer if frequent attendance before the court becomes necessary as a result of multiple applications under section 36 of the Act of 1970—to say nothing of the heavy inroads made upon court hearing time. One advantage of taking the period most favourable to the mortgagor at the outset is that, if his or her hopes of repayment prove to be ill-founded and the new instalments initially ordered as a condition of suspension are not maintained but themselves fall into arrear, the mortgagee can be heard with justice to say that the mortgagor has had his chance, and that the section 36 powers (although of course capable in theory of being exercised again and again) should not be employed repeatedly to compel a lending institution which has already suffered interruption of the regular flow of interest to which it was entitled under the express terms of the mortgage to accept assurances of future payment from a borrower in whom it has lost confidence.

Evans LJ

At 356

In conclusion, a practical summary of our judgments may be helpful in future cases. Drawing on the above and on the judgment of Waite L.J., the following considerations are likely to be relevant when a "reasonable period" has to be established for the purposes of section 36 of the Act of 1970. (a) How much can the borrower reasonably afford to pay, both now and in the future? (b) If the borrower has a temporary difficulty in meeting his obligations, how long is the difficulty likely to last? (c) What was the reason for the arrears which have accumulated? (d) How much remains of the original term? (e) What are relevant contractual terms, and what type of mortgage is it, i.e. when is the principal due to be repaid? (f) Is it a

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case where the court should exercise its power to disregard accelerated payment provisions (section 8 of the Act of 1973)? (g) Is it reasonable to expect the lender, in the circumstances of the particular case, to recoup the arrears of interest (1) over the whole of the original term, or (2) within a shorter period, or even (3) within a longer period, i.e. by extending the repayment period? Is it reasonable to expect the lender to capitalise the interest or not? (h) Are there any reasons affecting the security which should influence the length of the period for payment? In the light of the answers to the above, the court can proceed to exercise its overall discretion, taking account also of any further factors which may arise in the particular case.

Thus, the question to be considered by the court is whether, taking into account the whole of the term of the mortgage, it is likely that the borrower will be able to repay all that he or she owes the lender.[55] In coming to that decision, the court will need to consider the matters listed by Evans LJ, which, in turn, will require the parties to present to the court the necessary evidence, including detailed financial statements and projections of the borrower's likely income and outgoings, as well as evidence—for example, as to the spare equity in the property—which will enable the court to evaluate the exposure of the lender to a continuing risk of default. These guidelines reflect those contained in the MCOB 13 and the Pre-action Protocol (see section 1.2 above); namely that the lender should try to agree a reasonable rescheduling of the borrower's debt repayments before seeking repossession. Thus it may well be that the feasibility of the borrower being able to repay within a reasonable period has already been explored.

Another factor that may assist a borrower is the possibility of state assistance to meet mortgage interest repayments. For example, Support for Mortgage Interest may provide some help, although such assistance is limited and not immediately available.[56] The government have deliberately tried to restrict assistance to encourage borrowers to seek protection against the risk of a loss income as a result of sickness or redundancy, by taking out mortgage payment protection insurance[57] However, in the face of the credit crunch there has been a temporary relaxation of entitlement criteria.

The courts' approach to the interpretation of 'a reasonable period' is somewhat different where the borrower is proposing to clear his or her debt from a sale of property. In such circumstances, the total amount owed to the lender will be repayable, because the borrower will need to discharge the mortgage to sell the property. There must be some firm evidence that a sale is likely within the foreseeable future; a mere hope or an estate agent's optimistic projections are not enough.

[55] Although there is evidence that the courts in practice look to shorter periods, see Whitehouse, 'Longitudinal Analysis of the Mortgage Repossession Process 1995–2010: Stability, Regulation and Reform' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2011) pp 163–4.

[56] See Lundy, 'State Assistance with House Purchases: Mortgage Interest and Social Security' [1997] Conv 36; Morgan, 'Mortgages and a Flexible Workforce' in *Contemporary Property Law* (eds Jackson and Wilde, 1999); Citizens Advice (2007). The period before payments are made has been reduced for most claimants from thirty-nine weeks to thirteen weeks, and the house value ceiling for eligibility has been increased from £100,000 to £175,000.

[57] Although there has been considerable concern expressed over the marketing of this insurance (see Chapter 29, section 2.2.3), and such insurance provides protection for the lender's and not the borrower's loss: see *Woolwich Building Society v Brown* [1996] CLC 625; *Banfield v Leeds Building Society* [2007] EWCA Civ 1369.

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Bristol & West Building Society v Ellis
(1997) 73 P & CR 158, CA

Facts: Mrs Ellis had fallen into mortgage arrears after her husband left her. She unsuccessfully applied for suspension of a warrant for possession, on the basis that she would sell the property in three–five years' time, when her children had finished their full-time education. In support of her application, she provided estate agents' opinions showing that the likely sale price for the property should be sufficient to discharge the mortgage.

Auld LJ

At 161

The prospect of settling the mortgage debt, including arrears of principal and/or interest, by sale of the property raises a number of questions on the reasonableness of any period which a court may consider allowing for the purpose.

The critical matters are, of course, the adequacy of the property as a security for the debt and the length of the period necessary to achieve a sale. There should be evidence, or at least some informal material (see *Cheltenham & Gloucester Building Society v. Grant* (1994) 26 H.L.R. 703), before the court of the likelihood of a sale the proceeds of which will discharge the debt and of the period within which such a sale is likely to be achieved. If the court is satisfied on both counts and that the necessary period for sale is reasonable, it should, if it decides to suspend the order for possession, identify the period in its order [. . .]

It all depends on the individual circumstances of each case, though the important factors in most are likely to be the extent to which the mortgage debt and arrears are secured by the value of the property and the effect of time on that security.

Where the property is already on the market and there is some indication of delay on the part of the mortgagor, it may be that a short period of suspension of only a few months would be reasonable [. . .] Where there is likely to be considerable delay in selling the property and/or its value is close to the total of the mortgage debt and arrears so that the mortgagee is at risk as to the adequacy of the security, immediate possession or only a short period of suspension may be reasonable. Where there has already been considerable delay in realising a sale of the property and/or the likely sale proceeds are unlikely to cover the mortgage debt and arrears or there is simply no sufficient evidence as to sale value, the normal order would be for immediate possession. See, e.g. *Abbey National Mortgages plc v. Rochelle Bernard* (July 4, 1995, C.A. unreported) and *National Provincial Bank v Lloyd* [1996] 1 All ER 630.

Mr Duggan submitted that, here, the material, formal or informal (see *Grant*) before the district judge and judge was insufficient to satisfy them that Mrs Ellis would or could sell the property within three to five years or that its sale proceeds when sold would be sufficient to discharge the mortgage debt and arrears. As to the time of sale, all that the district judge had was her statement in her affidavit that she anticipated selling within three to five years when her children completed their education. As to value, the evidence was not compelling: two estate agents' estimates of between £80,000 and £85,000 as against the redemption figure at the time of just over £77,000 plus costs. As a result of Mrs Ellis's payment of the lump sum ordered by the district judge and subsequent payments, the total figure of indebtedness is now about £70,000, including about £10,000 arrears of interest. Given the inevitable uncertainty as to the movement of property values over the next few years and the reserve with which the courts should approach estate agents' estimates of sale prices (see *Clothier*) no court could be sanguine about the adequacy, now or continuing over that period, of the property as a security for the mortgage debt and arrears. In my view, the evidence was

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simply insufficient to entitle the district judge to contemplate, behind the order he made, a likelihood that the house would or could be sold at a price sufficient to discharge Mrs Ellis's overall debt to Bristol & West within any reasonable period, and certainly not one of up to three to five years.

There may be a distinct marketing advantage in the borrower selling the property rather than the lender doing so after entering into possession: a home will often look more attractive to a purchaser if it is occupied, and the knowledge that a sale is being forced by a mortgagee can depress the price. The borrower may, however, be slow to cooperate. In limited circumstances, a court may be persuaded that the benefits of allowing the borrower to conduct the sale outweigh the disadvantages and will suspend execution of a possession order accordingly. But it is clear that such a jurisdiction will not be exercised if the lender objects.

Cheltenham & Gloucester Plc v Booker
(1997) 73 P & CR 412, CA

Facts: The Bookers were in substantial arrears with their mortgage repayments and the Cheltenham & Gloucester had obtained an order for possession, the execution of which had been stayed on a number of occasions. The Bookers made an unsuccessful final application for stay, on the basis that they intended to sell, and requested that they be allowed to remain in possession pending the sale.

Millett LJ

At 415

[. . .] [I]t appears to me in principle difficult to deny the existence, at least in theory, of a similar jurisdiction to defer the giving of possession for a short time in order to enable the property to be sold by the mortgagee. If the court is satisfied (a) that possession will not be required by the mortgagee pending completion of the sale but only by the purchasers on completion; (b) that the presence of the mortgagor pending completion will enhance, or at least not depress, the sale price; (c) that the mortgagor will so cooperate in the sale by showing prospective purchasers round the property and so forth; and (d) that he will give possession to the purchaser on completion, it seems to me that there is no reason in principle why the court should accede to a mortgagee's insistence that immediate possession prior to the sale should be given to him.

However, while the jurisdiction exists, experience shows that these conditions are seldom likely to be satisfied. Accordingly, in my judgment, the jurisdiction should be sparingly exercised, and then exercised only with great caution. If the conditions which I have mentioned exist, the court is likely to entrust the conduct of the sale to the mortgagor. There is an inherent illogicality in entrusting conduct of the sale to the mortgagee and yet leaving the mortgagor in possession pending completion unless the mortgagee has agreed to this course. The obtaining of possession with a view to giving it to the purchaser is part of the necessary arrangements for sale. In my opinion the party having conduct of the sale ought normally to have the right to decide when it is desirable for him to obtain possession from those in occupation in order to enable the sale to be effectively carried through.

As the plaintiffs observe, in what I would wish to describe as a most impressive skeleton argument, if the contractual obligation to give vacant possession, which the mortgagee will

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wish to assume in order to obtain the best price reasonably obtainable, is separated from the ability to give immediate vacant possession, the mortgagee is put at risk of being in breach of contract through circumstances beyond his control. Moreover, if the conduct of the sale is given to the mortgagee, any prospective purchaser will become aware prior to exchange of contracts that the property is being sold by a mortgagee who has not yet obtained vacant possession. The risk that the borrower will not vacate the property on completion will become apparent and the purchaser may be deterred from proceeding. He will also be aware that the sale is a forced sale, the advantage of achieving a better price through continued owner occupation is unlikely to be realised.

Accordingly, while I would not wish to hold that the court has no jurisdiction in an appropriate case to make an order such as the judge made in the present case, it is hard to see the advantages of such an order and easy to see the disadvantages. I find it difficult to envisage circumstances in which such a course would be appropriate unless the mortgagee consented. It ought to be a rarity and taken only if the necessary conditions are satisfied.

2.5.5 Section 36 and court orders for sale under s 91

Section 91 of the LPA 1925 provides that a borrower may apply to the court for an order for sale.

Law of Property Act 1925, s 91

Sale of mortgaged property in action for redemption or foreclosure

1. Any person entitled to redeem mortgaged property may have a judgment or order for sale instead of for redemption in an action brought by him either for redemption alone or for sale alone, or for sale or redemption in the alternative.

2. In any action, whether for foreclosure, or for redemption, or for sale or for raising and payment in any manner of mortgage money, the court, on the request of the mortgagee, or any person interested either in the mortgage money or in the right of redemption, and, notwithstanding that—

(a) any other person dissents; or

(b) the mortgagee or any person so interested does not appear in the action;

and without allowing any time for redemption or for payment of any mortgage money, may direct a sale of the mortgaged property, on such terms as it thinks fit, including the deposit in court of a reasonable sum fixed by the court to meet the expenses of sale and to secure performance of the terms

The jurisdiction provides an alternative option for a borrower who wishes to solve his or her debt repayment problems through sale, although its application is limited. Traditionally, the jurisdiction was exercised only where there was a surplus between the value of the property and the outstanding mortgage, when it was not unusual to give the borrower the conduct of the sale. In *Palk v Mortgage Services Funding plc*,[58] the court was persuaded to use s 91

[58] [1993] Ch 330.

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to order sale on the application of the borrower where there was negative equity. The lender had wanted to delay sale until the market improved, and proposed, in the meantime, to take possession and let the property, applying the rental in partial discharge of the mortgage repayments—but this strategy would have resulted in mounting arrears. The Palks preferred an immediate sale to clear a good portion of their debt, leaving the balance unsecured.

The application of s 91 to instances in which there is negative equity can, however, be problematic: for example, where the borrower resorts to the jurisdiction as a delaying tactic or to try to gain control of the sale. Accordingly, the court will not usurp the lender's right to seek possession with a view to sale by suspending proceedings under s 36 to allow an application for sale under s 91.

Cheltenham & Gloucester plc v Krausz
[1997] 1 WLR 1558, CA

Facts: The Krauszs were in mortgage arrears and the Cheltenham & Gloucester had obtained an order for possession, the execution of which had been stayed on several occasions. The Krauszs found a purchaser for the property at £65,000, but the Cheltenham & Gloucester refused to agree to the sale, believing that the property was worth nearer £90,000. The Krauszs unsuccessfully applied for an order for sale under s 91(2) when their arrears totalled £83,000.

Phillips LJ

At 1562

Until *Palk's case* it was the practice of the Chancery court only to entertain an application for sale by the mortgagor if the proceeds of sale were expected to be sufficient to discharge the entirety of the mortgage debt. In such circumstances the mortgagor might initiate proceedings by bringing an action for sale under section 91(1), or, if the mortgagee sought to foreclose, the mortgagor could apply for an order for sale in place of foreclosure. The practice thus reflected the heading to section 91: "Sale of mortgaged property in action for redemption or foreclosure."

Palk's case established, for the first time, that the court has power under section 91(2) to make an order for sale on the application of a mortgagor, notwithstanding that the proceeds of sale will be insufficient to discharge the mortgage debt. In *Palk's case* the mortgagees had obtained an order for possession with the intention, not of proceeding to sell the property but of waiting in the hope that the market might improve. The mortgagor was anxious that the property should be sold so that the proceeds would reduce the mortgage debt, on which interest was accruing at an alarming rate. The Court of Appeal held that, as the mortgagees could buy the property themselves if they wished to speculate on an increase in its value, in the interests of fairness the property should be sold [. . .]

In cases before *Palk's case*, where the proceeds of sale were likely to exceed the mortgage debt, the court was prepared to entrust the sale to the mortgagor on the basis that the mortgagor had a keener interest than the mortgagee in obtaining the best price. [. . .]

In any case in which there is negative equity it will be open to the mortgagor to resist an order for possession on the ground that he wishes to obtain a better price by remaining in possession and selling the property himself. In not every case will the primary motive for such an application be the wish to obtain a better price than that which the mortgagee is likely to obtain on a forced sale. Often the mortgagor will be anxious to postpone for as long

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as possible the evil day when he has to leave his home. This court has ample experience of hopeless applications for leave to appeal against possession orders designed to achieve just that end. There will be a danger, if the mortgagee does not obtain possession, that the mortgagor will delay the realisation of the property by seeking too high a price, or deliberately procrastinating on completion. At present there is a simple procedure for seeking possession in the county court and the issue tends to be whether there are arrears and whether the mortgagor is likely to be able to discharge these in a reasonable time. If possession is to be suspended whenever this appears reasonable in order to give mortgagors the opportunity to sell the property themselves, the courts are going to have to enter into an area of difficult factual inquiry in order to decide in the individual case whether or not this course will be to the common benefit of mortgagor and mortgagee. Furthermore there will be obvious practical difficulties for mortgagees in monitoring the negotiations of mortgagors who are permitted time to market their properties. [. . .]

Before the decision in *Palk's case* it seemed that section 36 of the Act of 1970 and section 91 of the Act of 1925 were complementary. An application under section 91 would only be contemplated where the proceeds of sale were expected to exceed the mortgage debt. In these circumstances section 36 gave the court the power to suspend possession in order to enable an application for sale under section 91 to be made. It is, however, quite clear that section 36 does not empower the court to suspend possession in order to permit the mortgagor to sell the mortgaged premises where the proceeds of sale will not suffice to discharge the mortgage debt, unless of course other funds will be available to the mortgagor to make up the shortfall. A mortgagor seeking relief in the circumstances of *Palk's case* is thus unable to invoke any statutory power to suspend the mortgagee's right to enter into possession.

2.5.6 Right or remedy?

We have already noted that the lender enjoys a right to possession that is inherently independent of default. Section 36 is, however, an important jurisdiction that effectively controls the lender's right to possession of a dwelling house within a remedial context, and, as such, plays a vitally important social role. Nevertheless, as our survey of the jurisdiction has highlighted, its parameters are highly dependent on judicial interpretation, which has not always been able hold this social function firmly in its sights.

Haley, 'Mortgage Default: Possession, Relief and Judicial Discretion'
(1997) 17 LS 483, 483

The history of this interventionist jurisdiction is, however, chequered. It has been marked by the uneasy interaction between the laissez faire attitude of the common law (which upheld the lender's contract and estate rights) and the more protective and tender treatment of the mortgagor in equity (which, in appropriate cases, sought to restrict the exercise of those rights). The jurisdiction is now in statutory form, but the tension between the commercial interests of the mortgagee and the need for the mortgagor to maintain a home persists. Although the court must attempt to achieve a balance between those competing claims, under the present legal regime this is, patently, not a simple task. The judicial stance must necessarily reflect individual circumstances and broader notions of public interest, social and economic policy and parliamentary purpose. Consequently, the granting of relief against possession, as well as being reactive to prevailing community norms, is susceptible to major swings in judicial attitude and statutory constructions.

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The remedial context of the lender's right to possession is reinforced by the regulatory controls imposed by the FSMA 2000 through MCOB 13, as strengthened by the Pre-action Protocol. These measures are predicated on the policy that possession should be a measure of last resort and that it should not be used to harass borrowers in arrears. As such, they may sideline the s 36 jurisdiction and mean that it is increasingly difficult to justify the lender's inherent right to possession. The law should reflect the reality that possession is a remedy that should only be capable of exercise under the scrutiny of the court.[59]

McMurtry, 'Mortgage Default and Repossession: Procedure and Policy in the Post-*Norgan Era*' (2007) 58 NILQR 194, 207

> The regulatory reforms concerning the policy and procedure for dealing with arrears is disappointing and limited. The overriding concern is that a lender should give proper consideration to arrears issues, follow a documented approach and ensure that proper internal systems are put in place for the fair treatment of customers. Such goals are purely matters of form and operational procedure. As to the substantive rules governing borrower protection, there is nothing that is innovative [. . .] This regulatory response adds nothing to that adopted by the judiciary over the last ten years and does not operate to increase further the protection to borrowers in temporary financial straits. It is ironic that, instead, it might cause judicial sympathies to sway in favour of the institutional lender. First, it is possible that judges will be better disposed towards lenders who evidence the alteration of the terms of the mortgage contract in the prescribed ways. Secondly, it is likely that far fewer cases will come before the courts when the postponement of possession is the likely outcome. Thirdly, it is likely that more borrowers will have already benefited from a *Norgan* style repayment plan before the case ever reaches court. Of course, where there is little evidence of a desire on the lender's part to adhere to the spirit of the regulation, judicial sympathies will understandably shift towards the borrower. Nevertheless, it is only when the circumstances fall within the parameters of the *Norgan* liberality that the court will be able to maintain a roof over the borrower's head. As those parameters are likely to have already been reached, it is difficult to see how such sympathy can translate into effective relief.

2.6 HOME REPOSSESSION AND HUMAN RIGHTS

Section 36 may wrestle the exercise of a lender's right to possession within the court's control, but there are gaps in its application—most notably, where there is no need for the lender to apply to court for possession. Several commentators have raised the suggestion that the lender's right to possession conferred by s 87(1) of the LPA 1925 is incompatible with Art 8 (respect for the home).[60] The issue is of course one of horizontal application of the Convention standards between private parties but, given that the lender's right to possession is derived from statute, s 3 of the Human Rights Act requires this statutory right to be interpreted in a human rights compatible manner.[61] The question of

[59] As the Law Commission has recommended: see Law Commission Report No 204 (1991) [6.16], [7.28]–[7.38].

[60] See also Gray and Gray, *Elements of Land Law* (4th edn, 2005, [15.147]); Rook, *Property Law and Human Rights* (2001, p 199); Dixon, 'Sorry, We've Sold Your Home: Mortgagees and Their Possessory Rights' (1999) 58 CLJ 281.

[61] See Chapter 3.

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compatibility is governed by the familiar justification formula namely; whether or not the interference with the borrower's home presented by repossession, is justified, because it is lawful and serves a legitimate aim, which is necessary within a democratic society to address a pressing social need, yet is also proportionate in its effect upon the individual victim.[62] This call for proportionality necessitates an adequate process by which to assess the impact of the measure upon the personal circumstances of the borrower.[63] The exercise of a right to possession of the home must, thus, satisfy both substantive and procedural human rights standards. The fact that a lender's right to possession can be asserted, albeit in unusual circumstances, outside the court process leads to a direct clash with these standards.

Nield, 'Charges, Possession and Human Rights: A Reappraisal of s 87(1) Law of Property Act 1925' in *Modern Studies in Property Law: Vol 3* (ed Cooke, 2005,p 173)

The Strasbourg jurisprudence recognises that a lender's right to possession to facilitate the repayment of secured debt is a proportionate and legitimate aim. In *Wood v UK* (1997) 24 EHRR CD 69 the European Court, when considering Article 1 Protocol 1, stated that:

> [...] to the extent that the applicant is deprived of her possessions by repossession, the Commission considers that the deprivation is in the public interest, that is the public interest in ensuring the payment of contractual debts and is also in accordance with the rules provided by law.

And when considering Article 8:

> In so far as the repossession constituted an interference with the applicant's home the Commission finds that this was in accordance with the terms of the loan and the domestic law and was necessary for the protection of the rights and freedoms of others, namely the lender.

These comments presuppose the borrower is in default and the lender is seeking recourse to their security to obtain repayment. But where the borrower is not in default the lender's legitimate aim in obtaining possession is not so obvious unless it is to take steps to protect the value of the security.

Proportionality calls for an examination of the process by which a legitimate aim is achieved. So that, even though repossession to ensure the efficient repayment of debts is a legitimate aim, the means by which that repossession is obtained is a vital consideration under both Articles 1 and 8. The possibility that the lender may obtain possession without some form of judicial consideration over its exercise must tip the fair balance that lies at the heart of proportionality. [...] This concern with process operates despite the fact that Article 6 may not be engaged and provides the strongest argument that the right to possession conferred by subsection 87(1) is incompatible with the [Human Rights Act 1998] and thus should be amended.

However, even where a lender seeks a court order for possession does s 36 of the Administration of Justice Act 1970 provide a human rights compliant process? Section 36 is solely concerned with assessing the financial circumstances of the borrower and his or

[62] See Chapter 3.

[63] See *Manchester CC v Pinnock* [2010] UKSC 45 [2010] 3 WLR 1441; *Hounslow LBC v Powell* [2011] UKSC 8 [2011] 2 WLR 287.

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her ability to meet his or her debts. The court cannot take into account other factors: for example, the personal circumstances of the borrower or the welfare of children occupying the house as their home. As presently interpreted the court's discretion, thus, may not be wide enough to satisfy the demands of a human rights compatible process. By way of contrast, the welfare of children is an explicit factor in the exercise of the court's discretion to order the sale of co-owned property upon the application of a creditor under ss 14 and 15 of the Trusts of Land and Appointment of Trustees Act 1996 (TOLATA 1996).[64] This discriminatory treatment itself might engage Art 14 of the ECHR.[65]

3 SALE

The power of the lender to sell the mortgaged property without having to go to court is a powerful remedy. The lender can control the sale and recover the debt from the proceeds of a sale, accounting to the borrower (or a second chargee, if there is a subsequent mortgage) for any balance received in excess of the debt. In the conduct of the sale, the lender does have to act in a way that pays due regard to the interests of the borrower (or subsequent chargee).

Before examining the duties that a lender owes when selling the mortgaged property, we need to consider the mechanics of the sale itself.

3.1 MECHANICS OF SALE

3.1.1 Source of the power

The power of the lender to sell will be conferred either by the express terms of the legal charge or from the implied power contained in s 101(1)(i) of the LPA 1925 (extracted in section 1.1.2 above).

Where the power is express, the terms of the power should stipulate how and when it may be exercised. It is common for an express power of sale to be exercisable on specified events of default: for example, if the borrower fails to make an agreed repayment of capital or interest, or otherwise breaches any other covenant contained in the legal charge, or upon the borrower becoming insolvent.

Where a lender under a legal charge is relying upon its implied statutory power, there are two stages to be considered. Firstly, the power must arise: s 101(1)(i) provides that the power of sale arises when the mortgage money is due, being the legal date for redemption under the mortgage,[66] or, where the mortgage is repayable by instalments, when an instalment payment falls due.[67] Secondly, the power, once arisen, must become exercisable, which, in the case of the statutory power, is upon the events of default specified in s 103 of the 1925 Act although these events may be, and frequently are, varied by the express terms of the mortgage.

[64] See Chapter 18, section 3.3.
[65] See Fox, *Conceptualising Home* (2007), pp 500–3.
[66] *Twentieth Century Banking Corp v Wilkinson* [1977] Ch 99.
[67] *Payne v Cardiff RDC* [1932] 1 KB 241.

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Law of Property Act 1925, s 103

Regulation of exercise of power of sale

A mortgagee shall not exercise the power of sale conferred by this Act unless and until—

(i) Notice requiring payment of the mortgage money has been served on the mortgagor or one of two or more mortgagors, and default has been made in payment of the mortgage money, or of part thereof, for three months after such service; or

(ii) Some interest under the mortgage is in arrear and unpaid for two months after becoming due; or

(iii) There has been a breach of some provision contained in the mortgage deed or in this Act, or in an enactment replaced by this Act, and on the part of the mortgagor, or of some person concurring in making the mortgage, to be observed or performed, other than and besides a covenant for payment of the mortgage money or interest thereon.

The power of sale is thus exercisable only on default. In the case of a default in meeting a demand for full repayment, the borrower must be given notice and three months in which to comply with that notice; in the case of default in the payment of interest, no notice is required, but there must be at least two months' arrears.

In the case of a regulated mortgage, a longer process is contemplated. The MCOB 13 (extracted at section1.2 above), governing FSA-regulated mortgages, calls for the borrower to be given notice of any arrears, and for the lender to take reasonable steps to try to arrange the rescheduling of the debt before contemplating possession and sale; statutory default notices must be served where a mortgage is regulated under the CCA 1974.[68] Where the Pre-action Protocol is applicable because the lender is seeking possession prior to sale, the lender must also comply with the steps that it outlines.

Haley has pointed out that, in the case of a dwelling house, the impact of s 36 of the Administration of Justice Act 1970 will give the borrower more time in which to clear any arrears than is contemplated by s 103 of the LPA 1925,[69] and thus '*a long delay in the mortgagee's right to possession is by a side wind eroding the value of the statutory remedy*' of sale.[70] He observes that the separate control of the mortgagee's right to possession and its power of sale is artificial when the purpose of obtaining possession is to enable the lender to sell, and advocates reform to bring the remedies into line.[71] Otherwise, a lender may be tempted to sell without obtaining possession.[72]

3.1.2 Passing title

The mechanics of passing title by a mortgagee's sale is the subject of ss 88(1) (for mortgages over freeholds) and 89(1) (for mortgages over leaseholds) of the LPA 1925.

[68] Consumer Credit Act 1974 (as amended), ss 88B and 88C.

[69] Technically, the reverse could be the case where s 36 does not apply, although it is unlikely that a lender will act so precipitously.

[70] 'Mortgage Default: Possession, Relief and Judicial Discretion' (1997) 17 LS 483, 496.

[71] See also Gardner, *An Introduction to Land Law* (2009), [12.6.4].

[72] See *Ropaigealach v Barclays Bank plc* [2000] QB 263; *Horsham Properties Group Ltd v Clark* [2008] EWHC 2327.

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Law of Property Act 1925, s 88(1)

Realisation of freehold mortgages

1. Where an estate in fee simple has been mortgaged by the creation of a term of years absolute limited thereout or by a charge by way of legal mortgage and the mortgagee sells under his statutory or express power of sale—

(a) the conveyance by him shall operate to vest in the purchaser the fee simple in the land conveyed subject to any legal mortgage having priority to the mortgage in right of which the sale is made and to any money thereby secured, and thereupon;

(b) the mortgage term or the charge by way of legal mortgagee and any subsequent mortgage term or charges shall merge or be extinguished as respects the land conveyed; and such conveyance may, as respects the fee simple, be made in the name of the estate owner in whom it is vested.

The sale by the lender vests title in the purchaser by overreaching the borrower's equity of redemption, and any other interest over which the mortgage has priority, which vests instead in the proceeds of sale.[73] The mortgage itself and any subsequent charge are extinguished so far as they affect the land itself.

3.1.3 Application of proceeds of sale

By s 105 of the LPA 1925, the lender holds the proceeds of sale (after the discharge of any prior mortgages or encumbrances) in trust, to be applied in, firstly, the meeting the sale costs, and secondly, repaying the amount owing to it under the mortgage, with any balance being payable to the borrower or a subsequent mortgagee (if any).[74]

Law of Property Act 1925, s 105

Application of proceeds of sale

The money which is received by the mortgagee, arising from the sale, after discharge of prior incumbrances to which the sale is not made subject, if any, or after payment into court under this Act of a sum to meet any prior incumbrance, shall be held by him in trust to be applied by him, first, in payment of all costs, charges, and expenses properly incurred by him as incident to the sale or any attempted sale, or otherwise; and secondly, in discharge of the mortgage money, interest, and costs, and other money, if any, due under the mortgage; and the residue of the money so received shall be paid to the person entitled to the mortgaged property, or authorised to give receipts for the proceeds of the sale thereof.

A purchaser is not concerned to check that an event of default has occurred and the power of sale is exercisable,[75] nor is the purchaser concerned to see that the lender applies the sale

[73] See s 2(1)(iii), extracted at Chapter 19, section 2.1; *Horsham Properties Group Ltd v Clark* [2008] EWHC 2327.

[74] *West London Commercial Bank v Reliance Permanent Building Society* (1885) 29 Ch D 954.

[75] See Law of Property Act 1925, s 104, extracted at section 3.2.6 below.

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moneys as required by s 105. The receipt of the lender is a good discharge for the purchase money.[76] The purchaser must, however, check that the lender has a power of sale in the first place, either because the power is expressed in the legal charge, or because it is implied under s 101(1)(i). We will explore the position of the purchaser in more detail below.

3.1.4 Human rights and sale

We have noted that the lender's right to possession of a borrower's home may be incompatible with Art 8. A separate question is whether the lender's out of court power of sale (whether pursuant to an express or implied power) is an unjustified interference with a borrower's property rights under Art 1 Protocol 1 (Deprivation of Possessions). Briggs J in *Horsham Properties Group Ltd v Clark*[77] rejected this possibility. His primary ground was to reject the horizontal application of Art 1 Protocol 1 to a privately negotiated power of sale. He believed that an implied statutory power of sale also did not engage a horizontal application of Art 1 Protocol 1 because it '*serves to implement rather than override the private bargain between mortgagor and mortgagee*.'[78] Briggs J, in the following extract, went onto consider as obiter the human rights compatibility of the power of sale.

Horsham Properties Group Ltd v Clark
[2009] 1 WLR 1255

Facts: The lender, through its receivers, had sold the property without obtaining possession and their purchasers wanted to repossess the property. The borrowers' interest had been overreached by the sale, so they had no legal right to remain and were trespassers.

Briggs J

At [44]–[45]

In my judgment, any deprivation of possession constituted by the exercise by a mortgagee of its powers under section 101 of the Law of Property Act after a relevant default by the mortgagor is justified in the public interest, and requires no case-by case exercise of a proportionality discretion by the court, for the following reasons. First, it reflects the bargain habitually drawn between mortgagors and mortgagees for nearly 200 years, in which the ability of a mortgagee to sell the property offered as security without having to go to court has been identified as a central and essential aspect of the security necessarily provided if substantial property base secured lending is to be available at affordable rates of interest. That it is in the public interest that property buyers and owners should be able to obtain lending for that purpose can hardly be open to doubt, even if the loan-to-value ratios at which it has recently become possible have now become a matter of controversy.

Secondly, I am bound by the decision of the Court of Appeal in *Ropaigealach* to conclude that there was no wider policy behind section 36 of the Administration of Justice Act 1970 than to put back what the courts had shortly before taken away, namely a discretion to stay or adjourn proceedings for possession, triggered only where the mortgagee considered it necessary or appropriate to go to court if the first place. The question whether a wider policy ought to be implemented wherever steps taken by a mortgagee to release its security is likely to lead to the obtaining of possession is a matter for Parliament, and upon which Parliament has

[76] Ibid, s 107(1). [77] [2009] 1 WLR 1255. [78] Ibid, [35].

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> yet [. . .] to form any view. It would be quite wrong for the courts in a vigorous and imaginative interpretation of the Human Rights Convention to make that policy, as it were, on the hoof.

There is no doubt that a lender's power of sale can be substantively justified in human rights terms. It is the very essence of a security that the lender can recover his or her debt from a realization of the borrower's property. Indeed the Strasbourg Court has held as much in *Wood v UK*[79] in relation to both a potential interference with Art 1 Protocol 1 and Art 8. However, what Briggs J overlooks are the procedural imperatives that we have seen form an important part of the justification process.[80] Indeed the decision sparked significant concern, which has resulted in proposals for a lender, exercising its powers of enforcement of a mortgage from a residential owner-occupier, to obtain a court order either when taking possession or effecting a sale so as to afford the borrower the opportunity, at some point in the enforcement process, to access the courts' protection.[81]

3.2 DUTIES OF THE MORTGAGEE IN THE CONDUCT OF THE SALE

The lender has a direct interest in any sale, but so too does the borrower, because, as we have seen, he or she is entitled to any surplus sale proceeds. Even where the sale proceeds are insufficient to meet the sums owing to the lender, the borrower is still concerned, because he or she remains liable to meet the shortfall under the contractual covenant to repay. The balancing of the interests of both the lender and borrower is thus at the heart of the lender's duties upon the sale.

3.2.1 General principles

It has long been asserted that the lender is not a trustee of the power of sale, but the interests of the borrower cannot be ignored.[82] The lender cannot sell with the object of recovering only enough to repay the debt, because, in so doing, the borrower's interests are inevitably overlooked. Early decisions were somewhat ambiguous as to the scope of the lender's duties: it was unclear whether they were limited to a requirement of good faith or whether a degree of care was also required.[83] The law has developed to recognize both of these elements as interrelated strands of the duty that the lender owes the borrower in the conduct of the sale. The lender must, firstly, be able to demonstrate good faith, and secondly, that reasonable care has been taken in the conduct of the sale.

Cuckmere Brick Co v Mutual Finance
[1971] Ch 949, CA

Facts: The borrower owned land with planning permission to build a hundred flats. It subsequently obtained planning permission to build thirty-five houses. The lender

[79] (1997) 24 EHRR CD 69, [70]–[71].

[80] See Chapter 3 and section 2.6 above.

[81] Ministry of Justice, *Mortgages: Power of Sale and Residential Property* CP55/09 (December 2009).These proposals would not apply where the borrower had voluntarily given up possession.

[82] See *Nash v Eads* (1880) 25 SJ 95, although a lender is a trustee of the proceeds of sale: Law of Property Act 1925, s 105.

[83] Compare, for example, *Kennedy v de Trafford* [1896] 1 Ch 762 and *Tomlin v Luce* (1890) 43 Ch D 191.

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became entitled to exercise its power of sale, which it did by putting the land up for auction. The auctioneers referred only to the planning permission for the houses when marketing the property. The borrower brought the failure to refer to the earlier permission to the attention of the lender, which refused to postpone the sale, but asked the auctioneers to mention the planning permission at the auction. A sale price of £44,000 was achieved at the auction, although the borrower asserted that the land was worth nearer £75,000, which might have been achieved if the planning permission for the flats had been properly advertised. The borrower successfully brought an action for an account against the lender for the amount that should have been received from the sale.

Salmon LJ

At 965

It is well settled that a mortgagee is not a trustee of the power of sale for the mortgagor. Once the power has accrued, the mortgagee is entitled to exercise it for his own purposes whenever he chooses to do so. It matters not that the moment may be unpropitious and that by waiting a higher price could be obtained. He has the right to realise his security by turning it into money when he likes. Nor, in my view, is there anything to prevent a mortgagee from accepting the best bid he can get at an auction, even though the auction is badly attended and the bidding exceptionally low. Providing none of those adverse factors is due to any fault of the mortgagee, he can do as he likes. If the mortgagee's interests, as he sees them, conflict with those of the mortgagor, the mortgagee can give preference to his own interests, which of course he could not do were he a trustee of the power of sale for the mortgagor [. . .]

It is impossible to pretend that the state of the authorities on this branch of the law is entirely satisfactory. There are some dicta which suggest that unless a mortgagee acts in bad faith he is safe. His only obligation to the mortgagor is not to cheat him. There are other dicta which suggest that in addition to the duty of acting in good faith, the mortgagee is under a duty to take reasonable care to obtain whatever is the true market value of the mortgaged property at the moment he chooses to sell it: compare, for example, *Kennedy v. de Trafford* [1896] 1 Ch. 762; [1897] A.C. 180 with *Tomlin v. Luce* (1889) 43 Ch.D. 191, 194.

The proposition that the mortgagee owes both duties, in my judgment, represents the true view of the law. Approaching the matter first of all on principle, it is to be observed that if the sale yields a surplus over the amount owed under the mortgage, the mortgagee holds this surplus in trust for the mortgagor. If the sale shows a deficiency, the mortgagor has to make it good out of his own pocket. The mortgagor is vitally affected by the result of the sale but its preparation and conduct is left entirely in the hands of the mortgagee. The proximity between them could scarcely be closer. Surely they are "neighbours." Given that the power of sale is for the benefit of the mortgagee and that he is entitled to choose the moment to sell which suits him, it would be strange indeed if he were under no legal obligation to take reasonable care to obtain what I call the true market value at the date of the sale. Some of the textbooks refer to the "proper price," others to the "best price." Vaisey J. in *Reliance Permanent Building Society v. Harwood-Stamper* [1944] Ch. 362, 364, 365, seems to have attached great importance to the difference between these two descriptions of "price." My difficulty is that I cannot see any real difference between them. "Proper price" is perhaps a little nebulous, and "the best price" may suggest an exceptionally high price. That is why I prefer to call it "the true market value."

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Cross LJ, agreeing with Salmon LJ, also rejected the lender's submission that it should not be liable for a lack of care committed by its agent, provided that the appointment was reasonable. A lender is thus liable for a lack of care committed by any valuer, solicitor, or other agent that it may employ in the conduct of the sale.

Cuckmere Brick Co v Mutual Finance
[1971] Ch 949, CA

Cross LJ

At 966

Mr. Vinelott further submitted that even if we should be of opinion that a mortgagee was liable to account to the mortgagor for loss occasioned by his own negligence in the exercise of his power of sale, it was not right that he should be liable for the negligence of an agent reasonably employed by him. It may well be that this point is not open to him in view of the way the argument proceeded below—but in any case I do not accept the submission. In support of it, counsel pointed out that a trustee is not liable for the default of an agent whom it is reasonable for him to employ. But the position of a mortgagee is quite different from that of a trustee. A trustee has not, qua trustee, any interest in the trust property, and if an agent employed by him is negligent his right of action against the agent is an asset of the trust. A mortgagee, on the other hand, is not a trustee and if he sues the agent for negligence any damages which he can recover belong to him. Of course, in many cases the mortgagee may suffer no damage himself by reason of the agent's negligence because the purchase price, though less than it should have been, exceeds what is owing to the mortgagee. In such circumstances it may be that nowadays the law would allow the mortgagor to recover damages directly from the agent although not in contractual relations with him; but that was certainly not so a hundred years ago when *Wolff v. Vanderzee* (1869) 20 L.T. 353 was decided. In those days the only way to achieve justice between the parties was to say that the mortgagee was liable to the mortgagor for any damage which the latter suffered by the agent's negligence and to leave the mortgagee to recover such damages, and also any damage which he had suffered himself, from the agent. I do not think that we can say that the mortgagee used to be liable to the mortgagor for the negligence of his agent but that that liability disappeared at some unspecified moment of time when the law had developed enough to allow the mortgagor to sue the agent himself.

Salmon LJ's reference to 'neighbours' led subsequent judges to adopt a tortious interpretation for the basis of the lender's duties. But this approach has been discredited. The basis for the lender's duties arises in equity from the relationship of lender and borrower. As we have seen, the lender is under a duty to account to the borrower both for what he or she receives and for what he or she ought to receive.[84] It is from this obligation that the duty to exercise reasonable care in the conduct of the sale finds expression.[85]

[84] See section 2.2 above.
[85] See also *Downsview Nominees Ltd v First City Corp* [1993] AC 295, 315, *per* Lord Templeman.

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Silven Properties Ltd v Royal Bank of Scotland plc
[2004] 1 WLR 997, CA

Lightman J

At [19]

When and if the mortgagee does exercise the power of sale, he comes under a duty in equity (and not tort) to the mortgagor (and all others interested in the equity of redemption) to take reasonable precautions to obtain "the fair" or "the true market" value of or the "proper price" for the mortgaged property at the date of the sale, and not (as the claimants submitted) the date of the decision to sell. If the period of time between the dates of the decision to sell and of the sale is short, there may be no difference in value between the two dates and indeed in many (if not most cases) this may be readily assumed. But where there is a period of delay, the difference in date could prove significant. The mortgagee is not entitled to act in a way which unfairly prejudices the mortgagor by selling hastily at a knock-down price sufficient to pay off his debt: *Palk v Mortgage Services Funding plc* [1993] Ch 330, 337–338, per Sir Donald Nicholls V-C. He must take proper care whether by fairly and properly exposing the property to the market or otherwise to obtain the best price reasonably obtainable at the date of sale. The remedy for breach of this equitable duty is not common law damages, but an order that the mortgagee account to the mortgagor and all others interested in the equity of redemption, not just for what he actually received, but for what he should have received: see *Standard Chartered Bank Ltd v Walker* [1982] 1 WLR 1410, 1416b.

3.2.2 To whom is the duty owed?

The equitable nature of the lender's duties dictates both the parties to whom the duty is owed and the available remedies. The lender does not owe a duty to those whom it is foreseeable will suffer damage (being a tortious standard); its duty is relationship-based. It is owed to the borrower, a subsequent mortgagee, and any guarantor of the mortgage debt, but not to a beneficial owner, whose position is protected in equity by his or her relationship to the trustees of the legal estate, whom he or she may sue (if appropriate) for breach of trust.

We will look more closely at remedies below.

Parker-Tweedale v Dunbar Bank (No 1)
[1991] Ch 12, CA[86]

Facts: Mrs Parker-Tweedale held the legal estate in the family home on trust for her husband alone. When Mr Parker-Tweedale had a car accident, the Parker-Tweedales ran into financial difficulties and their marriage broke up. The bank exercised its power of sale and Mrs Parker Tweedale agreed the sale price of £575,000. A matter of weeks later, the purchaser sold the property for £700,000. Mr Parker-Tweedale unsuccessfully sought an order to set aside the sale.

[86] Noted at [1990] Conv 431.

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Nourse LJ

At 18

This reference to "neighbours" has enabled the plaintiff to argue that the duty is owed to all those who are within the neighbourhood principle; i.e., to adapt the words of Lord Atkin, to all persons who are so closely and directly affected by the sale that the mortgagee ought reasonably to have them in contemplation as being so affected when he is directing his mind to the sale. Further support for the application of the neighbourhood principle in this context can be gained from the judgment of Lord Denning M.R. in *Standard Chartered Bank Ltd. v. Walker* [1982] 1 W.L.R. 1410, 1415, where it was held that the duty to take reasonable care to obtain a proper price was owed to a surety for the mortgage debt as well as to the mortgagor himself.

In my respectful opinion it is both unnecessary and confusing for the duties owed by a mortgagee to the mortgagor and the surety, if there is one, to be expressed in terms of the tort of negligence. The authorities which were considered in the careful judgments of this court in *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd.* [1971] Ch. 949 demonstrate that the duty owed by the mortgagee to the mortgagor was recognised by equity as arising out of the particular relationship between them. Thus Salmon L.J. himself said, at p. 967:

> "It would seem, therefore, that many years before the modern development of the law of negligence, the courts of equity had laid down a doctrine in relation to mortgages which is entirely consonant with the general principles later evolved by the common law."

The duty owed to the surety arises in the same way. In *China and South Sea Bank Ltd. v. Tan Soon Gin (alias George Tan)* [1990] 1 A.C. 536, Lord Templeman, in delivering the judgment of the Privy Council, having pointed out that the surety in that case admitted that the moneys secured by the guarantee were due, continued at p. 543:

> "But the surety claims that the creditor owed the surety a duty to exercise the power of sale conferred by the mortgage and in that case the liability of the surety under the guarantee would either have been eliminated or very much reduced. The Court of Appeal [in Hong Kong] sought to find such a duty in the tort of negligence but the tort of negligence has not yet subsumed all torts and does not supplant the principles of equity or contradict contractual promises [. . .] Equity intervenes to protect a surety."

Once it is recognised that the duty owed by the mortgagee to the mortgagor arises out of the particular relationship between them, it is readily apparent that there is no warrant for extending its scope so as to include a beneficiary or beneficiaries under a trust of which the mortgagor is the trustee. The correctness of that view was fully established in the clear and compelling argument of Mr. Lloyd, who drew particular attention to the rights and duties of the trustee to protect the trust property against dissipation or depreciation in value and the impracticabilities and potential rights of double recovery inherent in giving the beneficiary an additional right to sue the mortgagee, a right which is in any event unnecessary.

The only exception for which Mr. Lloyd allowed was the special case where the trustee has unreasonably refused to sue on behalf of the trust or has committed some other breach of his duties to the beneficiaries, e.g., by consenting to an improvident sale, which disables or disqualifies him from acting on behalf of the trust. In such a case the beneficiary is permitted to sue on behalf of the trust. This exception is established by a series of authorities, some of which were recently considered by the Privy Council in *Hayim v. Citibank N.A.* [1987] A.C. 730. In delivering the judgment of their Lordships, Lord Templeman said, at p. 748:

> "These authorities demonstrate that a beneficiary has no cause of action against a third party save in special circumstances which embrace a failure, excusable or inexcusable, by the trustees

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in the performance of the duty owed by the trustees to the beneficiary to protect the trust estate or to protect the interests of the beneficiary in the trust estate."

It is important to emphasise that when a beneficiary sues under the exception he does so in right of the trust and in the room of the trustee. He does not enforce a right reciprocal to some duty owed directly to him by the third party.

3.2.3 The primacy of the lender's own interests

Although the lender owes a duty of good faith and of reasonable care in the conduct of the sale, the primary purpose of the power of sale is to safeguard the lender's own objective of securing repayment of the debt. As Salmon LJ pointed out in *Cuckmere Brick Co v Mutual Finance*,[87] the lender may thus choose whether and in what manner to exercise the power. In particular, the lender may choose its time of sale. The lender does not have to gauge the most opportune time to sell, nor is the lender required to wait for the market to recover, or to press ahead with a sale if prices are showing signs of falling.

For example, in the following case, the lender was not liable, although the value of the security—in this case, shares—had fallen dramatically following the collapse of the guarantor's property empire. Lord Templeman delivered the opinion of the Privy Council.

China and South Seas Bank Ltd v Tan
[1990] 1 AC 536, PC

Lord Templeman

At 545

If the creditor chose to exercise his power of sale over the mortgaged security he must sell for the current market value but the creditor must decide in his own interest if and when he should sell. [. . .]

No creditor could carry on the business of lending if he could become liable to a mortgagor and to a surety or to either of them for a decline in value of mortgaged property, unless the creditor was personally responsible for the decline [. . .] The creditor was not under a duty to exercise his power of sale over the mortgaged securities at any particular time or at all.

Similarly, a lender is not obliged to improve the mortgaged property to try to maximize the sale price. A lender that goes into possession is only obliged to take reasonable steps to ensure that the property does not deteriorate in value.

Silven Properties Ltd v Royal Bank of Scotland plc
[2004] 1 WLR 997, CA

Facts: The borrower alleged that the receiver appointed by the bank to sell the mortgaged property was under a duty to maximize its value by obtaining planning permission for

[87] [1971] Ch 949, CA.

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the development and letting some of the properties that were vacant. The receiver had explored the possibility of obtaining planning permission for some of the properties and of letting the vacant properties, but had decided to proceed to their immediate sale. The Court dismissed the borrower's allegation.

Lightman J

At [16]–[18]

The mortgagee is entitled to sell the mortgaged property as it is. He is under no obligation to improve it or increase its value. There is no obligation to take any such pre-marketing steps to increase the value of the property as is suggested by the claimants. The claimants submitted that this principle could not stand with the decision of the Privy Council in *McHugh v Union Bank of Canada* [1913] AC 299. Lord Moulton in that case, at p 312, held that, if a mortgagee does proceed with a sale of property which is unsaleable as it stands, a duty of care may be imposed on him when taking the necessary steps to render the mortgaged property saleable. The mortgage in that case was of horses, which the mortgagee needed to drive to market if he was to sell them. The mortgagee was held to owe to the mortgagor a duty to take proper care of them whilst driving them to market. The duty imposed on the mortgagee was to take care to preserve, not increase, the value of the security. The decision accordingly affords no support for the claimant's case

The mortgagee is free (in his own interest as well as that of the mortgagor) to investigate whether and how he can "unlock" the potential for an increase in value of the property mortgaged (e g by an application for planning permission or the grant of a lease) and indeed (going further) he can proceed with such an application or grant. But he is likewise free at any time to halt his efforts and proceed instead immediately with a sale. By commencing on this path the mortgagee does not in any way preclude himself from calling a halt at will: he does not assume any such obligation of care to the mortgagor in respect of its continuance as the claimants contend. If however the mortgagee is to seek to charge to the mortgagor the costs of the exercise which he has undertaken of obtaining planning permission or a lessee, subject to any applicable terms of the mortgage, the mortgagee may only be entitled to do so if he acted reasonably in incurring those costs and fairly balanced the costs of the exercise against the potential benefits taking fully into account the possibility that he might at any moment "pull the plug" on these efforts and the consequences for the mortgagor if he did so.

If the mortgagor requires protection in any of these respects, whether by imposing further duties on the mortgagee or limitations on his rights and powers, he must insist upon them when the bargain is made and upon the inclusion of protective provisions in the mortgage. In the absence of such protective provisions, the mortgagee is entitled to rest on the terms of the mortgage and (save where statute otherwise requires) the court must give effect to them. The one method available to the mortgagor to prevent the mortgagee exercising the rights conferred upon him by the mortgage is to redeem the mortgage. If he redeems, there can be no need or justification for recourse by the mortgagee to the power of sale to achieve repayment of the debt due to him secured by the mortgage.

The lender's freedom of action is, however, tempered by the combined duties of good faith and reasonable care. As Lightman LJ observes, if the borrower wishes to protect his or her position further, a higher duty must be negotiated when agreeing the mortgage terms with the lender.[88] It is more likely that the lender may try to limit its duties by the express terms of

[88] For example, MCOB13.6.1 provides that, where a lender takes possession under a mortgage regulated under the Financial Services and Markets Act 2000, the property should be marketed as soon as possible.

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the mortgage. But the courts have been reluctant to construe a purported limitation of liability by the lender as cutting down its duties of good faith and reasonable care. For example, in *Bishop v Bonham*,[89] a provision that stated that the lender could exercise its powers '*as it thought fit*' was construed as a discretion that could only operate within the constraints of good faith and reasonable care imposed by equity.

3.2.4 Reasonable care in the conduct of the sale

The lender is required to exercise reasonable care in the conduct of the sale. Earlier decisions refer to a need for the lender to take reasonable care to obtain a proper, fair, or true market price, but it is misleading to interpret this test as requiring the lender to attain a given valuation figure.[90] Rather, the courts, in determining liability, look to the reasonableness of the steps that the lender has taken to market the property and, in the light of these steps, to assess the price obtained against a valuation band that allows for some margin of judgment. It is only once the lender has been found to be in breach of its duty of care that the courts need to determine the price that should have been obtained, so that the damages payable to the borrower may be measured. The courts' focus is thus upon such matters as how the property was advertised or otherwise brought to the market,[91] whether a sale by auction or private treaty was more appropriate,[92] how the offer or reserve price was set,[93] how negotiations were conducted, and how the decision on the final sale price was reached.[94] In all of these steps, the advice of a suitably qualified agent will be influential in meeting the required objective standard of conduct.

Michael v Miller
[2004] 2 EGLR 151, CA

Facts: Michael's farm was mortgaged to Miller. Following Michael's default, the farm was sold for £1.625m. Michael called for an account, claiming that the farm was worth considerably more. The judge at first instance decided that the farm was worth £1.75m, but that an acceptable valuation band lay between £1.6m and £1.9m. Michael appealed unsuccessfully.

Jonathan Parker LJ

At [132]–[135]

It is a matter for the mortgagee how that general duty is to be discharged in the circumstances of any given case. Subject to any restrictions in the mortgage deed, it is for the mortgagee to decide whether the sale should be by public auction or private treaty, just as it is for him to decide how the sale should be advertised and how long the property should be left on the market. Such decisions inevitably involve an exercise of informed judgment on the part of the mortgagee, in respect of which there can, almost by definition, be no absolute requirements. Thus (as the judge recognised at p.68F of his judgment) there is no absolute duty to advertise widely. As he correctly put it (at p.69A):

[89] [1988] 1 WLR 742. [90] See *Corbett v Halifax Building Society* [2002] 1 WLR 964.
[91] For example, *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 494.
[92] For example, *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349.
[93] Ibid. [94] For example, *Michael v Miller* [2002] EWCA Civ 282.

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"What is proper advertisement will depend on the circumstances of the case."

Similarly, in some cases the appropriate mode of sale may be sale by public auction (in the instant case, no one has suggested that); in others, for example where there is a falling market, it may not. Moreover, a mortgagee who receives an offer in advance of an auction may have to make a judgment as to whether to accept it or whether to proceed to the auction.

The need for the mortgagee to exercise informed judgment in exercising his power of sale in turn means that a prudent mortgagee will take advice, including (where appropriate) valuation advice, from a duly qualified agent.

I turn, then, to the position of a mortgagee's agent such as Mr Hextall, whose duties included the giving of valuation advice. In my judgment, just as, applying the *Bolam* principle, a valuer will not breach his duty of care if his valuation falls within an acceptable margin of error (see, e.g., *Merivale Moore* and the *Arab Bank case*), so a mortgagee will not breach his duty to the mortgagor if in the exercise of his power to sell the mortgaged property he exercises his judgment reasonably; and to the extent that that judgment involves assessing the market value of the mortgaged property the mortgagee will have acted reasonably if his assessment falls within an acceptable margin of error [. . .]

At [138]–[139]

I accordingly reject Mr Jourdan's submission that as a matter of principle a 'bracket' approach is inappropriate in the context of the exercise of a mortgagee's power of sale. In so far as the exercise of the mortgagee's power of sale calls for the exercise of informed judgment by the mortgagee, whether as to market conditions, or as to market value, or as to some other matter affecting the sale, the use of a bracket—or a margin of error—must in my judgment be available to the court as a means of assessing whether the mortgagee has failed to exercise that judgment reasonably.

It seems to me that Mr Jourdan's submissions on the bracket issue confuse the issue of breach of duty with the measure of damages should breach of duty be established. As Lord Hoffmann said in *Saamco* at p.221F:

> "Before I come to the facts of the individual cases, I must notice an argument advanced by the defendants concerning the calculation of damages. They say that the damage falling within the scope of the duty should not be the loss which flows from the valuation having been in excess of the true value but should be limited to the excess over the highest valuation which would not have been negligent. This seems to me to confuse the standard of care with the question of the damage which falls within the scope of the duty. The valuer is not liable unless he is negligent. In deciding whether or not he has been negligent, the court must bear in mind that valuation is seldom an exact science and that within a band of figures valuers may differ without one of them being negligent. But once the valuer has been found to have been negligent, the loss for which he is responsible is that which has been caused by the valuation being wrong. For this purpose the court must form a view as to what a correct valuation would have been. This means the figure which it considers most likely that a reasonable valuer, using the information available at the relevant date, would have put forward as the amount which the property was most likely to fetch if sold upon the open market. While it is true that there would have been a range of figures which the reasonable valuer might have put forward, the figure most likely to have been put forward would have been the mean figure of that range. There is no basis for calculating damages upon the basis that it would have been a figure at one or other extreme of the range. Either of these would have been less likely than the mean [. . .]"
>
> [. . .]

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At [141]

In the instant case the judge took the, to my mind, somewhat unsatisfactory course of deciding first what was the market value of the Estate at the relevant time (concluding that it was £1.75M) and then asking himself whether the respondents, through Mr Hextall, were negligent in achieving a price substantially less than that. The judge's approach might perhaps be appropriate in a case where the mortgagee accepts the first offer that he receives, without the property having been exposed to the market at all. In such a case, the likelihood is that the only evidence of 'market value' will be expert valuation evidence. But where, as in the instant case, the property has been exposed to the market and a number of genuine offers have been received, the more logical approach (to my mind) is to start by considering the steps which the mortgagee took to sell the property and then to consider whether, in all the circumstances, the mortgagee acted reasonably in accepting the purchaser's offer and contracting to sell the property at that price.

3.2.5 The duty of good faith

A lender must exercise the power of sale in good faith. The impact of this requirement is most obvious where the lender is selling to a connected party, when there is a conflict of interest, and where the lender's motive for selling is improper.

A mortgagee cannot sell to itself, or to a trustee or agent acting on its behalf. In the words of Lindley LJ in *Farrars v Farrars Ltd*,[95] '[a] *sale by a person to himself is no sale at all*'. The lender can sell to a company or other organization in which it is interested, or to a person with whom it is connected, but, if the lender does so, the court will scrutinize the lender's conduct to ensure that reasonable care has been taken.[96] In the Hong Kong case of *Tse Kwong Lam v Wong Chit Sen*,[97] Lord Templeman, giving the opinion of the Privy Council, stated that '*the sale must be closely examined and a heavy onus lies on the mortgagee to show that in all respects he acted fairly to the borrower and used his best endeavours to obtain the best price reasonably obtainable for the mortgaged property*'.

The case itself provides a useful example. The respondent exercised his power of sale by putting the mortgaged property up for auction. The auction was only advertised very shortly before it was conducted and only limited details were provided. A reserve price was fixed, but without the guidance of a qualified valuer. At the auction, only one bid at the reserve price was made—by the respondent's wife, acting on behalf of a company owned by the respondent and his family. The Privy Council held that, although the respondent was free to sell to a company in which he was interested, he had failed to demonstrate that he had taken reasonable care in the conduct of the sale. An auction was not necessarily the most appropriate mode of sale. The mortgagee should have sought the advice of a suitably qualified expert both as to the mode of sale, and, if the property was to be auctioned, regarding the reserve price and appropriate marketing.

A lender's motives may also affect its bona fides. In *Quennell v Maltby*,[98] we saw that the right to take possession must not be exercised for an ulterior motive. Likewise, the power of sale must be exercised with a view to discharging the mortgage debt. In *Downsview Nominees*

[95] (1889) 40 Ch D 395, 409.

[96] *Mortgage Express v Mardner* [2004] EWCA Civ 1859; *Bradford & Bingley plc v Ross* [2005] EWCA Civ 394.

[97] [1983] 1 WLR 1349, 1355.

[98] [1979] 1 WLR 318.

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Ltd v First City Corp Ltd,[99] in which receivers were appointed purely to frustrate the exercise of a second mortgagee's powers, there was '*overwhelming evidence that the receivership of the second defendant was inspired by him for an improper purpose and carried on in bad faith, verging on fraud*'. Mixed motives will not, however, breach the mortgagee's duties, provided that one of those motives was to recover the debt.[100]

3.2.6 Remedies and the position of purchasers

What action can a borrower take if a lender is in breach of its duties? He or she may either seek an order setting aside the sale, or an order for an account requiring the lender to account for what ought to have been received to compensate the borrower for any shortfall in the purchase price for which the lender is responsible. An order for an account will be the usual course where the lender has fallen short of the objective standard of care. An order to set aside the sale will not be available where the lender has merely sold at an undervalue; there must be some impropriety. The court has discretion to set aside the sale and a court will not do so if there has been an unwarranted delay,[101] or if to do so would cause unnecessary hardship.[102] Furthermore, the position of the purchaser, against whom the sale is to be set aside, must also be considered.

Section 104 of the LPA 1925 provides some protection.

Law of Property Act 1925, s 104

Conveyance on sale

1. A mortgagee exercising the power of sale conferred by this Act shall have power, by deed, to convey the property sold, for such estate and interest therein as he is by this Act authorised to sell or convey or may be the subject of the mortgage, freed from all estates, interest, and rights to which the mortgage has priority, but subject to all estates, interests, and rights which have priority to the mortgage.

2. Where a conveyance is made in exercise of the power of sale conferred by this Act, or any enactment replaced by this Act, the title of the purchaser shall not be impeachable on the ground:

(a) that no case had arisen to authorise the sale; or

(b) that due notice was not given; or

(c) where the mortgage is made after the commencement of this Act, that leave of the court when so required, was not obtained; or

(d) whether the mortgage was made before or after such commencement, that the power was otherwise improperly or irregularly exercise;

and a purchaser is not, either before or on conveyance concerned to see or inquire whether a case has arisen to authorise the sale, or due notice has been given, or the power is otherwise properly and regularly exercised; but any person damnified by an unauthorised or improper, or irregular exercise of the power shall have his remedy in damages against the person exercising the power.

99 [1993] AC 295, 317.

100 *Meretz Investment NV v ACP Ltd* [2007] EWCA Civ 303, [2008] Ch 244.

101 See *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349.

102 *Corbett v Halifax Building Society* [2002] EWCA Civ 1849, [2003] 1 WLR 964.

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The extent of this protection is limited. It relieves the purchaser from making enquiries as to whether an event of default has occurred to trigger the exercise of a power of sale, but does not protect the purchaser if he or she has actual notice of the impropriety:

Corbett v Halifax Building Society
[2003] 1 WLR 964, CA

Facts: Although it was contrary to his terms of employment, an employee of the Halifax purchased, though his uncle, a repossessed property from his employer at a sum that the court found to be an undervalue. The Halifax was unaware of its employee's participation in the sale. The borrowers unsuccessfully applied to set aside the sale.

Pumfrey J

At [25]–[26]

Between contract and completion, the position is described in *Lord Waring v London and Manchester Assurance Co Ltd* [1935] Ch 310, 318–319 where in a passage subsequently approved by the Court of Appeal in *Property and Bloodstock Ltd v Emerton* [1968] Ch 94, Crossman J said:

> "The only effect of the conveyance is to put the legal estate entirely in the purchaser: that follows from section 104, subsection (1), of the Law of Property Act 1925, which provides that a mortgagee shall have power to convey the legal estate; and the whole legal estate can be conveyed free from all estates, interests, and rights to which the mortgage has priority. Section 104, subsection (2), upon which also counsel for the plaintiff relied, does not seem to me to affect the question at all. Its purpose is simply to protect the purchaser and to make it unnecessary for him, pending completion and during investigation of title, to ascertain whether the power of sale has become exercisable. Of course, if the purchaser becomes aware, during that period, of any facts showing that the power of sale is not exercisable, or that there is some impropriety in the sale, then, in my judgment, he gets no good title on taking the conveyance. The result in the present case is, in my judgment, that the sale effected by the contract, assuming, for the moment, that there is no objection to it on any other ground, binds the plaintiff, and that it is too late after the sale for him to tender the mortgage money and become entitled to have the property reconveyed to him [. . .]"

It would seem to follow from this that a completed sale by a mortgagee is not liable to be set aside merely because it takes place at an undervalue. Impropriety is a prerequisite, and section 104(2) makes it clear that the purchaser is not protected if he has actual knowledge of the impropriety. But if the purchaser has no notice of the impropriety, then on the face of it he takes free. Thus, the completed sale by a mortgagee pursuant to his statutory power is vulnerable only if the purchaser has knowledge of, or participates in, an impropriety in the exercise of the power.

The Halifax was bona fide throughout; it was its employee, acting without its knowledge, who was acting improperly. Although the Halifax had sold at an undervalue, a mere undervalue was insufficient to set a sale aside; there had to have been impropriety.

Section 104 will also not assist a purchaser of unregistered land where the lender has no power of sale, for example, because the mortgage is invalid or contains no adequate power of

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sale, or because any power that there is has not arisen. The lender is acting beyond its powers and any sale is ultra vires.

Where the land is registered and the lender is selling under a registered charge, the provisions of s 52 of the Land Registration Act 2002 (LRA 2002) must be considered.

Land Registration Act 2002, s 52

Protection of disponees

1. Subject to any entry in the register to the contrary, the proprietor of a registered charge is to be taken to have, in relation to the property subject to the charge, the powers of disposition conferred by law on the owner of a legal mortgage.

2. Subsection (1) has effect only for the purpose of preventing the title of a disponee being questioned (and so does not affect the lawfulness of a disposition).

A purchaser may thus assume that a registered chargee enjoys all of the powers of a legal mortgagee unless a restriction is registered, giving notice that these powers have been restricted. As we have noted, the power of sale under s 101(1)(i) of the LPA 1925 must have arisen, because the mortgage money is due, before it can become exercisable. It is thought that the power of sale must have arisen before a purchaser can take advantage of the protection afforded by s 52 of the LRA 2002. The section provides protection to a purchaser where the sale is within the powers of the lender (i.e. intra vires), but is actionable by the borrower because the power has not yet become exercisable or is liable to be set aside (e.g. for impropriety). In these circumstances, there remains the possibility that a purchaser who is implicated in, or has knowledge of, a breach of the mortgagee's equitable duties may be liable as a constructive trustee on the basis of knowing receipt.[103]

4 APPOINTMENT OF A RECEIVER

The implied power to appoint a receiver of the mortgaged land when the mortgage money has become due is conferred by s 101(1)(iii) of the LPA 1925 into all mortgages created by deed, including a legal charge by way of mortgage. The appointment of a receiver provides an attractive option for a lender under a mortgage of commercial property, because a lender can avoid personal liability for wilful default or for breach of duty if the property is sold. The remedy is particularly popular where a legal charge of land owned by a company is coupled with a floating charge over all of the assets and undertakings of a company, under which the lender may appoint either an administrative receiver or administrator to take over the effective running of the company in the event of its insolvency.[104]

[103] See Chapter 19, section 6.3.2.

[104] A floating charge entered into prior to 15 September 2003 may contain an express right to appoint an administrative receiver over all of the assets and undertakings of the company. By s 72A of the Insolvency Act 2006, a lender is no longer entitled to appoint an administrative receiver, but may appoint an administrator. The distinction between an 'administrative receiver' and an 'administrator' is that an administrative receiver owes duties only to the secured lender and the borrower, whilst an administrator's duties extend to all of the creditors of the company, both secured and unsecured.

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4.1 FUNCTIONS AND POWERS OF A RECEIVER

Section 109 of the LPA 1925 provides that a receiver may be appointed or removed by written notice, whereupon the receiver is entitled to enter into possession of the property to preserve the security and to collect any income that may be applied, after payment of any costs and expenses including the receiver's remuneration, in the repayment of the interest due, with any balance being payable to the borrower or the person next entitled to the equity of redemption. A receiver is invariably also granted express powers to manage and sell the property. By appointing a receiver, a lender can thus indirectly enforce the legal charge.

Section 109 contains the implied terms that govern the appointment of a receiver under s 101(1)(iii) of the Act.

Law of Property Act 1925, s 109

Appointment, power, remuneration and duties of a receiver

1. A mortgagee entitled to appoint a receiver under the power in that behalf conferred by this Act shall not appoint a receiver until he has become entitled to exercise the power of sale conferred by this Act, but may then, by writing under his hand, appoint such person as he thinks fit to be receiver.

2. A receiver appointed under the powers conferred by this Act, or any enactment replaced by this Act, shall be deemed to be the agent of the mortgagor; and the mortgagor shall be solely responsible for the receiver's acts or defaults unless the mortgage deed otherwise provides.

3. The receiver shall have power to demand and recover all the income of which he is appointed receiver, by action, distress, or otherwise, in the name either of the mortgagor or of the mortgagee, to the full extent of the estate or interest which the mortgagor could dispose of, and to give effectual receipts accordingly for the same, and to exercise any powers which may have been delegated to him by the mortgagee pursuant to this Act.

4. A person paying money to the receiver shall not be concerned to inquire whether any case has happened to authorise the receiver to act.

5. The receiver may be removed, and a new receiver may be appointed, from time to time by the mortgagee by writing under his hand.

6. The receiver shall be entitled to retain out of any money received by him, for his remuneration, and in satisfaction of all costs, charges, and expenses incurred by him as receiver, a commission at such rate, not exceeding five per centum on the gross amount of all money received, as is specified in his appointment, and if no rate is so specified, then at the rate of five per centum on that gross amount, or at such other rate as the court thinks fit to allow, on application made by him for that purpose.

4.2 RECEIVER AS AGENT FOR THE BORROWER

A lender is able to avoid personal liability by appointing a receiver, because the receiver is expressed to be the agent of the borrower, although appointed by and taking directions from the lender. A receiver thus owes duties both to the lender and the borrower, creating a rather

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unusual triangular relationship. In effect, by entering into the legal charge, the borrower empowers the lender to appoint the receiver as the borrower's agent in applying the income from the property, and (where express power is granted) to sell and apply the proceeds of sale in the discharge of the mortgage debt.

Silven Properties Ltd v Royal Bank of Scotland plc
[2004] 1 WLR 997, CA

Lightman J

At [27]–[28]

The peculiar incidents of the agency are significant. In particular: (1) the agency is one where the principal, the mortgagor, has no say in the appointment or identity of the receiver and is not entitled to give any instructions to the receiver or to dismiss the receiver. In the words of Rigby LJ in *Gaskell v Gosling* [1896] 1 QB 669, 692: "For valuable consideration he has committed the management of his property to an attorney whose appointment he cannot interfere with"; (2) there is no contractual relationship or duty owed in tort by the receiver to the mortgagor: the relationship and duties owed by the receiver are equitable only: see *Medforth v Blake* [2000] Ch 86 and *Raja v Austin Gray* [2003] 1 EGLR 91; (3) the equitable duty is owed to the mortgagee as well as the mortgagor. The relationship created by the mortgage is tripartite involving the mortgagor, the mortgagee and the receiver; (4) the duty owed by the receiver (like the duty owed by a mortgagee) to the mortgagor is not owed to him individually but to him as one of the persons interested in the equity of redemption. The class character of the right is reflected in the class character of the relief to be granted in case of a breach of this duty. That relief is an order that the receiver account to the persons interested in the equity of redemption for what he would have held as receiver but for his default; (5) not merely does the receiver owe a duty of care to the mortgagee as well as the mortgagor, but his primary duty in exercising his powers of management is to try and bring about a situation in which the secured debt is repaid: see the *Medforth case* at p 86; and (6) the receiver is not managing the mortgagor's property for the benefit of the mortgagor, but the security, the property of the mortgagee, for the benefit of the mortgagee: see *In re B Johnson & Co (Builders) Ltd* [1955] Ch 634, 661, per Jenkins LJ cited with approval by Lord Templeman in *Downsview Nominees Ltd v First City Corpn Ltd* [1993] AC 295, 313b, and [1955] Ch 634, 646, per Evershed MR cited with approval by Sir Richard Scott V-C in the *Medforth case* [2000] Ch 86, 95h-96a. His powers of management are really ancillary to that duty: *Gomba Holdings UK Ltd v Homan* [1986] 1 WLR 1301, 1305, per Hoffmann J.

In the context of a relationship such at the present, which is no ordinary agency and is primarily a device to protect the mortgagee, general agency principles are of limited assistance in identifying the duties owed by the receiver to the mortgagor: see *Gomba Holdings UK Ltd v Homan* at 1305b-d (Hoffmann J) and *Gomba Holdings UK Ltd v Minories Finance Ltd* [1988] 1 WLR 1231, 1233d-h (Fox LJ). The core duty of the receiver to account to the mortgagor subsists, but (for example) the mortgagor has no unrestricted right of access to receivership documents. The mortgage confers upon the mortgagee a direct and indirect means of securing a sale in order to achieve repayment of his secured debt. The mortgagee can sell as mortgagee and the mortgagee can appoint a receiver who likewise can sell in the name of the mortgagor. Having regard to the fact that the receiver's primary duty is to bring about a situation where the secured debt is repaid, as a matter of principle the receiver must be entitled (like the mortgagee) to sell the property in the condition in which it is in the same

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way as the mortgagee can and in particular without awaiting or effecting any increase in value or improvement in the property [. . .]

In practice, a receiver, before accepting an appointment, will invariably require an indemnity from the lender against any personal liability that the receiver may incur. Nevertheless, the appointment of receiver is an attractive and popular power available to a lender where the lender anticipates that a sale may not immediately follow the taking of possession, or the property will need to be managed prior to sale: for example, because it is tenanted or is used for business purposes.

4.3 DUTIES OF A RECEIVER

In the following case, the receiver had explored, but rejected, the possibility of improving the property prior to sale. It was argued that, because the receiver was an agent of the borrower, he or she owed a duty to the borrower to present the property for sale in its most advantageous condition, and thus his or her decision not to proceed with the improvements was a breach of this duty. In view of the unique features of the agency, however, this argument was rejected. The receiver's duties were the same as those owed by a mortgagee.

Silven Properties Ltd v Royal Bank of Scotland plc
[2004] 1 WLR 997, CA

Lightman J

At [29]

[. . .] [B]y accepting office as receivers of the claimant's properties the receivers assumed a fiduciary duty of care to the bank, the claimants and all (if any) others interested in the equity of redemption. This accords with the statement of principle to this effect of Lord Browne-Wilkinson in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205e-h relied on by the claimants. The appointment of the receivers as agents of the claimants having regard to the special character of the agency does not affect the scope or the content of the fiduciary duty. The scope or content of the duty must depend on and reflect the special nature of the relationship between the bank, the claimants and the receivers arising under the terms of the mortgages and the appointments of the receivers, and in particular the role of the receivers in securing repayment of the secured debt and the primacy of their obligations in this regard to the bank. These circumstances preclude the assumption by, or imposition on, the receivers of the obligation to take the pre-marketing steps for which the claimants contend in this action. Further no such obligation could arise in their case (any more than in the case of the bank) from the steps which they took to investigate and (for a period) to proceed with applications for planning permission. The receivers were at all times free (as was the bank) to halt those steps and exercise their right to proceed with an immediate sale of the mortgaged properties as they were.

In *Downsview Nominees v First City Corp*,[105] the Privy Council had decided that a receiver owed the same equitable (not tortious) duties to act bona fide and with reasonable care in

[105] [1993] AC 295. See also *Yorkshire Bank Plc v Hall* [1999] 1 WLR 1713.

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the conduct of any sale. But a receiver's role is often rather different from that of a mortgagee: a receiver is given powers to manage the property, including (where a floating charge is granted over the borrower's business assets) any business that may be conducted on the land. As a result, he or she is unable to sit back and do nothing; he or she is obliged to act to preserve the interest of the borrower and the lender.[106]

Medforth v Blake
[2000] Ch 86, CA

Facts: Medforth was a pig farmer. When he ran into financial difficulties, Blake was appointed a receiver and manager under the terms of charges secured over the business. In running the business, Blake incurred losses and Medforth successfully claimed that his failure to obtain discounts on bulk purchases of pig feed had contributed to those losses, for which he should be liable to account.

Sir Richard Scott VC

At 98

The *Cuckmere Brick case* test can impose liability on a mortgagee notwithstanding the absence of fraud or mala fides. It follows from the *Downsview Nominees case* and *Yorkshire Bank Plc. v. Hall* that a receiver/manager who sells but fails to take reasonable care to obtain a proper price may incur liability notwithstanding the absence of fraud or mala fides. Why should the approach be any different if what is under review is not the conduct of a sale but conduct in carrying on a business? If a receiver exercises this power, why does not a specific duty, corresponding to the duty to take reasonable steps to obtain a proper price, arise? If the business is being carried on by a mortgagee, the mortgagee will be liable, as a mortgagee in possession, for loss caused by his failure to do so with due diligence. Why should not the receiver/manager, who, as Lord Templeman held, owes the same specific duties as the mortgagee when selling, owe comparable specific duties when conducting the mortgaged business? It may be that the particularly onerous duties constructed by courts of equity for mortgagees in possession would not be appropriate to apply to a receiver. But, no duties at all save a duty of good faith? That does not seem to me to make commercial sense nor, more importantly, to correspond with the principles expressed in the bulk of the authorities . . . . In my judgment, in principle and on the authorities, the following propositions can be stated. (1) A receiver managing mortgaged property owes duties to the mortgagor and anyone else with an interest in the equity of redemption. (2) The duties include, but are not necessarily confined to, a duty of good faith. (3) The extent and scope of any duty additional to that of good faith will depend on the facts and circumstances of the particular case. (4) In exercising his powers of management the primary duty of the receiver is to try and bring about a situation in which interest on the secured debt can be paid and the debt itself repaid. (5) Subject to that primary duty, the receiver owes a duty to manage the property with due diligence. (6) Due diligence does not oblige the receiver to continue to carry on a business on the mortgaged premises previously carried on by the mortgagor. (7) If the receiver does carry on a business on the mortgaged premises, due diligence requires reasonable steps to be taken in order to try to do so profitably.

106 See *Silven Properties Ltd v Royal Bank of Scotland plc* [2004] 1 WLR 997, [23].

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5 A FINAL WORD ABOUT THE COVENANT TO REPAY

Possession, sale, and appointment of a receiver are all proprietary remedies flowing from the security created by the legal charge by way of mortgage, but it should not be forgotten that the borrower is under a personal contractual liability to repay the loan in accordance with the terms of the loan agreement. A term for repayment of the capital of the loan will be implied in the absence of an express term.[107] This liability is independent of the security and will remain where there is a shortfall after the lender or receiver has sold the property. Thus, where there is negative equity, a borrower may be sued by the lender for the balance that remains owing after the sale proceeds have been applied in repayment. In enforcing that judgment, the lender is in no better position than any other unsecured creditor and may be forced to make the borrower bankrupt.

In suing upon the personal covenant to repay, the lender must bear in mind the relevant limitation periods. The recovery of interest is statute-barred six years[108] after becoming due and the capital, as a debt payable by deed, cannot be recovered after twelve years from the date upon which it became due.[109] The exercise by the lender of its power of sale does not affect these periods.[110]

QUESTIONS

1. Is it satisfactory that the lender has an immediate right to possession, or do the existing qualifications to this right provide adequate safeguards?
2. Compare the different approaches to the width of the courts' discretion under s 36 of the Administration of Justice Act 1936 that were taken in *Cheltenham & Gloucester Building Society v Norgan* and *Bristol & West Building Society v Ellis*. Do you think that the courts' approach in both cases is consistent?
3. Why would a borrower wish to apply to court for an order for sale under s 91 of the Law of Property Act 1925? When is a court likely to be sympathetic to such an application?
4. A lender's duties, in exercise of its power of sale, arise in equity rather than in tort, but what consequences flow as a result?
5. In exercise of its power of sale, a lender has a duty to obtain a proper market price. What does this mean and what would you advise a lender to do in order to fulfil this duty?
6. In what circumstances could a borrower successfully apply to set aside a sale made by a lender?

[107] *West Bromwich Building Society v Wilkinson* [2005] UKHL 44, noted at Prime, 'Mortgage Default, Limitation and Law Reform' [2005] Conv 566.

[108] Limitation Act 1980, s 20(5).

[109] Ibid, s 20(1), but see MCOB 13.6.1 and 13.6.2, which effectively reduce the period to six years where the mortgage is regulated.

[110] *West Bromwich Building Society v Wilkinson* [2005] UKHL 44.

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FURTHER READING

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Haley, 'Mortgage Default: Possession, Relief and Judicial Discretion' (1997) 17 LS 483

McMurtry, 'Mortgage Default and Repossession: Procedure and Policy in the Post-*Norgan* Era' (2007) 58 NILQR 194

Nield, 'Charges Possession and Human Rights: A Reappraisal of s 87(1) Law of Property Act 1925' in *Modern Studies in Property Law: Vol 3* (ed Cooke, Oxford: Hart, 2005)

Whitehouse, 'Longitudinal Analysis of the Mortgage Repossession Process 1995-2010: Stability, Regulation and Reform' in *Modern Studies in Property Law Vol 6* (ed Bright, Oxford: Hart, 2010) ch 7

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