

# The Law Commission

(LAW COM. No. 204)

## TRANSFER OF LAND—LAND MORTGAGES

*Laid before Parliament by the Lord High Chancellor  
pursuant to section 3(2) of the Law Commissions Act 1965*

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*Ordered by The House of Commons to be printed  
13 November 1991*

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The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

The Commissioners are:

The Honourable Mr Justice Peter Gibson, *Chairman*

Mr Trevor M. Aldridge

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# TRANSFER OF LAND—LAND MORTGAGES

## CONTENTS

	<i>Paragraph</i>	<i>Page</i>
<b>PART I: INTRODUCTION</b>	1.1	1
Introduction	1.1	1
Background to the Report	1.4	1
Contents of the Report	1.6	2
<b>PART II: STRUCTURAL REFORM</b>	2.1	3
The Need for Reform	2.1	3
Defects in the Present Law	2.6	4
Multiplicity of types of mortgage	2.6	4
Legal mortgage	2.7	5
Equitable mortgage of a legal estate	2.8	5
Equitable mortgage of an equitable interest	2.10	6
Equitable charge	2.12	7
Reduction in number of types of security	2.13	7
Removal of the distinction between mortgages and charges	2.14	7
Inappropriateness of form	2.17	8
Mortgage by demise	2.18	8
Mortgage by Assignment	2.19	9
The Working Paper Proposals	2.20	9
Reasons for rejecting Proposals III and IV	2.21	9
Reasons for rejecting Proposal II	2.23	10
<b>PART III: FORMAL AND INFORMAL LAND MORTGAGES</b>	3.1	12
Nature of the New Mortgage	3.1	12
Variable and overriding provisions	3.3	12
General limitation on exercise of rights etc.	3.4	13
Method of Creation	3.5	13
Formal Land Mortgage	3.5	13
Recognition of Informal Mortgages	3.9	14
Nature of Informal Mortgage	3.11	15
Method of Creating Informal Land Mortgage	3.14	16
Registration and Priority	3.18	16
Protection and Priority in Registered Land	3.20	17
Formal land mortgage of a legal estate	3.20	17
Informal land mortgage of a legal estate	3.21	17

	<i>Paragraph</i>	<i>Page</i>
Priority of informal land mortgages of a legal estate	3.22	19
Formal and informal mortgages of an equitable interest	3.23	19
Protection and Priority in Unregistered Land	3.30	22
Formal and informal mortgages of a legal estate	3.31	22
Formal and informal mortgages of equitable interests	3.33	23
Other amendments to the Land Charges Act 1972	3.34	23
Summary of the New Mortgage Structure	3.35	24
<b>PART IV: PROTECTED MORTGAGES</b>	4.1	25
The need for a protected class of mortgage	4.1	25
Agricultural land	4.7	26
Mixed business and residential premises	4.8	26
Consumer Credit Act 1974	4.9	27
<b>PART V: FORM OF FORMAL LAND MORTGAGE</b>	5.1	28
Standardisation	5.1	28
Standard forms	5.2	28
Standard terms	5.5	29
Prescribed information	5.9	31
Effect of failure to comply with requirements	5.12	32
<b>PART VI: RIGHTS AND DUTIES OF THE PARTIES</b>		
<b>DURING THE SECURITY</b>	6.1	34
Introduction	6.1	34
Standard Provisions	6.4	34
Documents of title	6.4	34
Insurance	6.9	35
Repair and condition of the property	6.13	37
Possession	6.16	38
Powers of leasing	6.17	38
Other matters relating to the relationship of the parties during the security	6.22	40
Transfer of the mortgage	6.22	40
Transfer of the mortgagor's interest	6.31	43
Regulation of interest rates	6.32	43
Increase of rate of interest on default	6.33	43
Regulation of variable interest rates	6.35	44
Redemption	6.42	46
Consolidation	6.44	47
Discharge	6.45	48

	<i>Paragraph</i>	<i>Page</i>
<b>PART VII: ENFORCEMENT OF THE</b>		
<b>SECURITY</b>	7.1	49
Introduction	7.1	49
The Remedies	7.4	49
Power of Sale	7.5	49
When the power becomes exercisable	7.6	49
Enforceable events	7.8	50
Additional requirements for protected mortgages	7.11	51
Enforcement notice procedure	7.12	51
Extra-judicial enforcement	7.14	52
Exercise of power of sale after mortgagor		
contracts to sell	7.16	53
Protection of purchaser on sale by mortgagee	7.20	54
Sale by mortgagee to itself	7.22	54
Mortgagee's duty on sale	7.23	55
Proceeds of sale	7.25	55
Foreclosure	7.26	56
Possession	7.28	56
Possession for the purpose of sale	7.29	56
Cesser of interest	7.33	57
Possession to preserve the value of the mortgaged		
property	7.36	59
Liability of mortgagee in possession	7.37	59
Appointment of a Receiver	7.39	60
When the power is exercisable	7.42	61
Powers of receiver	7.43	61
Receiver's duty to account	7.44	62
Qualifications of a receiver	7.46	62
Powers of leasing	7.47	63
Jurisdiction of the Court on Enforcement	7.48	63
Protection of Tenants of the Mortgagor	7.54	65
<b>PART VIII: JURISDICTION TO SET ASIDE</b>		
<b>OR VARY TERMS OF THE</b>		
<b>MORTGAGE</b>	8.1	67
Introduction	8.1	67
New Statutory Jurisdiction	8.4	67
<b>PART IX: MISCELLANEOUS MATTERS</b>	9.1	69
Tacking of Further Advances	9.1	69
Land Mortgages and the Consumer Credit Act 1974	9.6	70

	<i>Paragraph</i>	<i>Page</i>
Transitional Provisions	9.7	70
Statutory Charges	9.11	71
Effect on the Crown	9.12	71
<b>PART X: SUMMARY OF RECOMMENDATIONS</b>	10.1	72
<b>APPENDIX A: Draft Land Mortgages Bill with Explanatory Notes</b>		81
<b>APPENDIX B: List of individuals and organisations who submitted comments on Working Paper No. 99</b>		151
<b>APPENDIX C: List of participants in the Seminar on Land Mortgages held at the Law Commission on 31st August 1987</b>		152
<b>APPENDIX D: Statement of Practice issued by the Department of the Environment and H.M. Treasury Working Group on the Secondary Mortgage Market (1989)</b>		153
<b>APPENDIX E: Section 7 of the Local Government Act 1986</b>		155
<b>APPENDIX F: The Local Authorities (Disposal of Mortgages) Regulations 1986, S.I. 1986, No. 1028.</b>		156
<b>APPENDIX G: Note on the effect of the new scheme on mortgages created by standard form debenture deeds.</b>		158

# THE LAW COMMISSION

## Item 4 of the Fourth Programme: Transfer of Land

### LAND MORTGAGES

*To the Right Honourable the Lord Mackay of Clashfern,  
Lord High Chancellor of Great Britain*

#### PART I

#### INTRODUCTION

##### Introduction

1.1 In this Report we consider the law relating to consensually created securities over interests in land.<sup>1</sup> This is part of our programme of examining conveyancing with a view to its modernisation and simplification.

1.2 We recommend in this Report that all existing methods of consensually mortgaging or charging interests in land should be abolished by legislation and replaced by a new form of mortgage to be used for mortgaging any interest in land, whether legal or equitable. We make further recommendations about the rights and duties of the parties to the new mortgage, and about its regulation and enforcement. A draft Bill to implement our recommendations appears as Appendix A to this Report.

1.3 These reforms are radical in that a new simplified mortgage structure will be erected in place of the complex structure that now exists. But in making these broad recommendations affecting an important area of commercial activity, and many people's housing, we have been careful to ensure that the essentials of the familiar mortgage system should be continued, and indeed strengthened. For a new class of "protected mortgages",<sup>2</sup> we recommend new safeguards for mortgagors. But in general our reforms do not envisage changes to the basic provisions of the law. Rather, those familiar rules would be presented in a way which was simpler, clearer, more logical and consistent and easily accessible than at present.

##### Background to the Report

1.4 In 1986 we published a Working Paper<sup>3</sup> in which we examined the defects in the present law of mortgages of interests in land. The provisional view expressed in the Working Paper was that the law was in need of simplification and modernisation and that in order to achieve this it was necessary to reconsider first, the structure of the mortgage relationship and secondly, the rights, duties, protection and remedies of the parties to the relationship, both during the security and on its enforcement. The Working Paper put forward for consideration five sets of proposals for reform. The first four, Proposals I to IV, presented four different options for structural reform. The fifth, Proposal V, contained a series of proposals relating to such matters as rights and duties of the parties and enforcement of the security, to be combined with any one of Proposals I to IV.

1.5 In response to the Working Paper we received many valuable comments on the need for reform in general, and on the particular proposals for reform we had made. A list of those who commented is set out as Appendix B. Response to the Working Paper revealed overwhelming support for our provisional view that mortgage law ought to be simplified and rationalised. It also revealed several issues which we thought merited further discussion between some of those who had commented on the Working Paper. As a further step in the consultation process we therefore held a seminar at the Commission on 31 July 1987 at which participants explained and discussed the views they had expressed to the

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<sup>1</sup> By "consensually created securities" we mean all mortgages, charges and other security interests voluntarily created or granted by the mortgagor/chargor (including those deemed to have been created or granted voluntarily, in the special circumstances explained in para. 2.10(a) below). We do not deal in this Report with non-consensual security interests (i.e. equitable charges arising by operation of law, statutory charges and liens), nor do we deal specifically with floating charges. See further para. 2.6 below.

<sup>2</sup> Mortgages by an individual of property including a dwelling-house, with certain exceptions: see para. 4.6 below.

<sup>3</sup> Land Mortgages, Working Paper No. 99.

Commission. A list of those who participated in the seminar is set out as Appendix C: their assistance in the consultation process, in the form of both their original written responses and their subsequent attendance at and participation in the seminar was extremely valuable and we wish to record our gratitude to them. Finally, we would like to record our particular indebtedness to Alison Clarke, Senior Lecturer in Laws at University College, London, for the extensive help she has given us throughout our work on this project, culminating in undertaking the bulk of the work on the preparation of this Report. We are also very grateful to our former colleague, Dr. Julian Farrand, who was responsible for initiating work on this topic and for taking it forward to the point at which the policy reflected in this Report was adopted and who, after he left the Commission, provided valuable assistance and advice during the preparation of this Report.

### **Contents of the Report**

1.6 The recommendations we make in the light of this consultation are set out in this Report. In Part II we consider the need for reform and explain why we now reject the limited reforms canvassed in the Working Paper as Proposals II to IV, in favour of the radical reform set out in Proposal I. The new form of mortgage we recommend should be introduced, the formal land mortgage, is described in Part III, where we also consider the circumstances in which an informal land mortgage should be recognised and enforceable. In Part IV we examine the arguments for having a protected class of mortgage, and explain what mortgages we recommend should come within such a class. Part V deals with matters relating to the form of the new mortgage. Part VI describes the rights and duties of the parties to a formal and informal land mortgage during the security, and makes recommendations about the extent to which the freedom of the parties to vary these statutory rights and duties should be restricted and regulated. In Part VII we consider and make recommendations about enforcement of the security. Part VIII contains recommendations for rationalising the law relating to the jurisdiction of the courts to set aside or vary the terms of the mortgage, and Part IX, under the heading Miscellaneous Matters, contains recommendations for the reform of the doctrine of tacking of further advances, the effect of our recommendations on the Consumer Credit Act 1974 and on statutory charges, and the transition from the present mortgage system to the new system. Finally, a Summary of Recommendations is given in Part X.

## PART II

### STRUCTURAL REFORM

#### The Need for Reform

2.1 Most of those who responded to the Working Paper agreed with our conclusion that the major defect in the law of land mortgages is that it is unnecessarily complicated. Over the years it has achieved a state of artificiality and complexity that is now difficult to defend.<sup>1</sup> This is not only annoying and time wasting for everyone personally and professionally concerned with mortgages. It also has two effects that are particularly undesirable at the present time. The first is that it impedes understanding: it hampers the drafting of comprehensible mortgage documents, and makes it difficult to ensure that the parties to a mortgage fully understand the rights and obligations they acquire as a result of entering into the transaction, and the consequences of default in repayments. Given the importance of land mortgages in this country in relation to the provision of housing and the financing of industry, and the present concern about the increase in the rate of defaults, this is a serious defect in the law.

2.2 This difficulty in understanding mortgages is compounded by the fact that there is no comprehensive statutory statement of the relevant law. While the rules developed over the years by the courts may themselves be clear and well known to specialists in the field, the fact that much of what has been enacted must be supplemented from other sources, in order to be fully understood, makes the law on this topic much less accessible than we consider is desirable and appropriate.

2.3 The second ill-effect of the artificiality and complexity of the law is that it complicates conveyancing, in particular because it makes it more difficult to develop standardised mortgage documents. Greater standardisation of mortgage documents has frequently been urged as a means of simplifying residential conveyancing.<sup>2</sup> Whether standardisation is to be imposed by law or developed voluntarily by lenders, the process would be very much easier if mortgage law could be simplified.

2.4 The increase in the rate of defaults referred to in paragraph 2.1 above is a development we noted in the Working Paper, and it has continued to grow since then.<sup>3</sup> Responses to the Working Paper and studies published subsequently<sup>4</sup> have confirmed our

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<sup>1</sup> For criticism of the present law see in particular G. A. Grove, *Conveyancing and the Property Acts of 1925* (1961) 24 M.L.R. 123, p. 131; P. Jackson, *The Need to Reform the English Law of Mortgages* (1978) 94 L.Q.R. 571.

<sup>2</sup> The Royal Commission on Legal Services described mortgages as "ripe for standardisation" in 1979 (Final Report of The Royal Commission on Legal Services (1979) Cmnd. 7648, Annex 21.1, para. 14), and standardisation of mortgage deeds and other documents was the subject of a strong recommendation by the Conveyancing Committee in its Second Report in 1985 (paras. 6.39-6.40 and 7.19-7.20, and also para. 9.32). See too Lord Templeman's address to the Society of Computers and Law (1986) 49 Computers and Law 16.

<sup>3</sup> In para. 1.3 of the Working Paper we noted that the number of mortgage possession actions, including residential and non-residential mortgages, entered in the County Court in England and Wales each year increased from 27,105 in 1980 to 64,301 in 1985. The equivalent figures for 1988 and 1989 were 72,655 and 91,418 respectively (Judicial Statistics Annual Report 1989, Cm. 1154, table 4.6). Figures for the first six months of 1991, supplied by the Lord Chancellor's Department, show that 92,966 applications were made and a total of 65,746 possession orders made. Between 1981-1989, the number of residential mortgages subsisting increased from 5,490,000 in 1981 to 7,674,000 in 1989. (No later figures are available.) In residential cases, the figures for (a) properties taken into possession and (b) mortgages six to twelve months in arrear show interesting fluctuations within this general upward trend. In a recent press release (15 February 1990) the Council of Mortgage Lenders reported: "The number of properties taken into possession during 1989 as a whole [13,780] was the lowest recorded since 1984 [when the figure was 10,872: the equivalent figure in 1979 was 2,530, and the highest recorded figure was 22,930 in 1987] and 14% down on the 1988 figure. However, during the second half of [1989] 7,430 properties were taken into possession, 17% higher than in the first half of 1989. The number of mortgages six to twelve months in arrear rose by 29% between the end of June 1989 and the end of December. At the end of 1989 58,380 loans were six to twelve months in arrear. In relation to loans outstanding this is the highest figure since arrears peaked in the first half of 1986 [in fact the peak 1986 figure was lower, at 53,170]. The number of mortgages more than twelve months in arrear rose by 31% on the mid-year total and at the end of the year stood at 12,100." Figures for mortgages in arrear do not include properties taken into possession. A reasonably accurate figure for the number of residential mortgage defaults in 1989 would therefore be 84,260, with the equivalent figure for 1982 being 34,550. In *Social Trends 20* (1990, H.M.S.O.), the fall in the number of defaults between 1986 and the beginning of 1989 is attributed to "[t]he trough in mortgage interest rates in mid-1988 and improvements in building society arrears counselling procedures" (p. 135).

<sup>4</sup> For example, J. Ford, *Building Society Mortgage Arrears 1983-87*, Loughborough University of Technology (1987); J. Ford and L. Took, "Building Society Mortgage Arrears" in J. Doling, J. Ford and B. Stafford, *A Property Owning Democracy* (1988); J. Ford, *The Indebted Society: Credit and Default in the 1980s* (1988); National Consumer Council, *Security Risks: Personal Loans Secured On Homes* (1987) and *Credit and Debt—The Consumer Interest* (1990, H.M.S.O.); E. Kempson, *Debt Recovery and Money Advice: A Literature Review Prepared for the National Consumer Council* (1988).

doubts about the effectiveness of the present law in dealing with the problems raised by mortgage default, particularly in relation to residential mortgages.<sup>5</sup> Whilst an analysis of the causes of the increase in defaults is beyond the scope of this Report, it is sufficiently clear that changes in mortgage law cannot be expected to have a dramatic effect on the *level* of defaults.<sup>6</sup> However, we believe that significant improvements can and should be made to the ways in which the law regulates the consequences of default. This is an area of mortgage law that has suffered particularly badly from the process of piecemeal reform we described in paragraphs 2.1 to 2.4 of the Working Paper. The enforcement system that has resulted from this process displays the artificiality and complexity that characterise the rest of mortgage law, and this has affected the way it has been able to respond to the problems raised by the increase in the rate of default. As a result, we believe, it does not always provide adequate protection for mortgagors, nor does it always operate with the efficiency and certainty required by mortgagees.<sup>7</sup>

2.5 The artificiality and complexity we refer to in the preceding paragraphs are largely attributable to problems in the structure of English mortgage law. In particular, there are two broad structural problems to which most of the unnecessary complications in the law can be ascribed. First, English law recognises too many types of consensual mortgage or charge, and too many methods of creating some of the types. Secondly, the methods used to create legal and equitable mortgages in the present law give rise to inappropriate relationships between the parties, which have had to be modified by equity, by piecemeal statutory reform, and by contract. This process has been particularly apparent (and, we believe, has had particularly unfortunate results) in the areas of mortgagor protection and enforcement of the security. In the Working Paper we explained the historical evolution of these now undesirable features of mortgage law, and we need not repeat that explanation here.<sup>8</sup> We shall, however, repeat our explanation of these structural problems because there have been some developments in the law since publication of the Working Paper.

## **Defects in the Present Law**

### *Multiplicity of types of mortgage*

2.6 English law recognises many different security interests in land. A legal estate in land may be “mortgaged” by two types of legal mortgage (a mortgage by demise or a charge by way of legal mortgage), or by an equitable mortgage, or by a consensually created equitable charge (which may be either fixed or floating) or by an equitable charge arising by operation of law, or by a statutory charge (which may be specified to take effect either as if it were a legal mortgage, or as if it were an equitable charge), or (possibly) by a lien. An equitable interest in land may be “mortgaged” by any of the same devices except a mortgage by demise and a charge by way of legal mortgage.<sup>9</sup> In this Report we do not deal with non-consensual security interests (that is, equitable charges arising by operation of law, statutory charges and liens) nor with floating charges.<sup>10</sup> In Part IX of this Report and in Appendix G we consider the extent to which their operation will be affected by our recommendations.

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<sup>5</sup> In the case of mortgages of commercial premises, mortgage default is likely to be linked to failure in the business (whether as a cause or an effect). Defaults in commercial mortgages are therefore likely to be dealt with in the context of insolvency of the business, making it difficult to assess the effectiveness of mortgage law in dealing with defaults in isolation from the effects of insolvency law.

<sup>6</sup> Although we believe an important contribution can be made by the measures we recommend for ensuring that those contemplating a mortgage of their property are forewarned of the consequences of entering into the mortgage: see para. 2.1 above, and also the recommendations we make in Part V below about the form and content of mortgages of dwelling houses, in particular paras. 5.2 and 5.11 (prescribed standard forms) and 5.9 and 5.11 (prescribed information to be contained in mortgage deeds, and provision of copies).

<sup>7</sup> See further Part VII of this Report, where we explain the anomalies and defects (both technical and practical) in the present enforcement system, and set out our recommendations for change. For the recommendations most relevant to the problems discussed in this paragraph, see paras. 7.6 to 7.11 (circumstances in which the mortgage becomes enforceable); paras. 7.12 to 7.14, 7.32, 7.36(d), 7.42(b), and 7.47(c) (mandatory enforcement notice procedure for residential mortgages, and no enforcement of residential mortgages without a court order); paras. 7.28 to 7.35 (measures to ensure that mortgagees who take possession from the mortgagor do not unduly delay sale of the property); and paras. 7.48 to 7.53 (giving the court wider powers on an application to enforce a residential mortgage).

<sup>8</sup> Working Paper, paras. 2.1 to 2.4.

<sup>9</sup> Also, any statutory charge over an equitable interest must necessarily take effect as an equitable, rather than a legal, charge.

<sup>10</sup> Floating charges are created by companies over all types of property and not only, or even primarily, interests in land. Recommendations for their reform were made by Professor A. L. Diamond in *Review of Security Interests in Property Other Than Land* (1989, H.M.S.O.). However, the Government have decided not to implement those recommendations in England and Wales: *Hansard* (H.C.), 24 April 1991, vol. 189, col. 482w.



### *Legal Mortgage*

2.7 A legal mortgage can be granted over a legal estate (or interest) only. There are two ways of creating a legal mortgage: the mortgagor must either execute a demise for a term of years absolute<sup>11</sup> (“a mortgage by demise”) or must execute a charge which is expressed to be by way of legal mortgage (“a charge by deed expressed to be by way of legal mortgage”).<sup>12</sup> The charge by way of legal mortgage was created by the Law of Property Act 1925, and was defined in the 1925 Act solely in terms of the mortgage by demise:<sup>13</sup> it is now established that, as a consequence of this, a mortgage by demise and a charge by way of legal mortgage are identical in effect.<sup>14</sup> A legal mortgage (whether a mortgage by demise or a charge by way of legal mortgage) must be made by deed.<sup>15</sup> As an additional requirement in registered land, neither a mortgage by demise nor a charge by way of legal mortgage can take effect as a legal mortgage unless it is substantively registered.<sup>16</sup>

### *Equitable mortgage of a legal estate*

2.8 An equitable mortgage is created over a legal estate whenever there is an enforceable agreement to mortgage but insufficient formalities to create a legal mortgage. The circumstances in which it arises can be put into two categories:

- (a) *A formal agreement to create a legal mortgage.* The agreement itself creates an equitable mortgage provided it is specifically enforceable. If made after 27 September 1989 there will be no valid agreement (and *a fortiori* no question of specific performance) unless section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 is satisfied<sup>17</sup> (that is, the agreement must be made by writing signed by both mortgagor and mortgagee, and incorporating all the terms expressly agreed between the parties). Even if there is a valid agreement, it will not be specifically enforceable unless the loan which the mortgage is intended to secure has been made.<sup>18</sup> Subject to the formal requirements imposed by section 2 of the 1989 Act, the agreement need not be in any particular form.
- (b) *An informal mortgage.* An equitable mortgage arises where the mortgagor evinces an intention to create an immediately effective mortgage<sup>19</sup> but (deliberately or accidentally) fails to complete all the formalities necessary to create a legal mortgage. Although void at law, the mortgage is valid in equity provided it is in writing signed by the mortgagor.<sup>20</sup> Informal mortgages were once commonly used instead of legal mortgages in order to save stamp duty and land registration fees. However, mortgage stamp duty was abolished in 1971<sup>21</sup> and exemption from land registration fees for the registration of mortgages was extended soon afterwards.<sup>22</sup> The only reasons for now deliberately choosing to take an equitable rather than a

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<sup>11</sup> Law of Property Act 1925, s. 85. If the mortgaged property is a lease, the demise will be a sub-demise for a term which is at least one day shorter than the unexpired residue of the lease: *ibid.*, s. 86.

<sup>12</sup> *Ibid.*, ss. 85(1) and 86(1).

<sup>13</sup> *Ibid.*, s. 87(1).

<sup>14</sup> Fisher and Lightwood, *Law of Mortgage* (10th ed., 1988), p. 43.

<sup>15</sup> Law of Property Act 1925, s. 52(1): “mortgage” comes within the definition of “conveyance” given in s. 205(1)(ii).

<sup>16</sup> Land Registration Act 1925, s. 106(2) as substituted by the Administration of Justice Act 1977, s. 26(1).

<sup>17</sup> Section 2 applies to any “contract for the sale or other disposition of an interest in land”: see s. 2(1). “Disposition” has the same meaning as in the Law of Property Act 1925 (s. 2(6) of the 1989 Act) and hence includes mortgage (s. 205(1)(ii) of the 1925 Act). Section 2 of the 1989 Act implements recommendations we made in our Report on Formalities for Contracts for the Sale etc. of Land, (1987) Law Com. No. 164.

<sup>18</sup> If the mortgage secures an antecedent debt or some other obligation or liability, the mortgagee seeking specific performance must have provided some other consideration, such as a forbearance from suing.

<sup>19</sup> Contrast an intention to create a *charge*: see paras. 2.12 and 2.14 below.

<sup>20</sup> This is probably by virtue of Law of Property Act 1925, s. 53(1)(a), although it could be argued that the relevant statutory provision is now s. 2 of the Law of Property (Miscellaneous Provisions) Act 1989. This is because the traditional rationale of the rule that an informal mortgage takes effect as an equitable mortgage is that equity treated the void legal mortgage as a valid *agreement* to mortgage, and hence (by virtue of the principle explained in para. 2.8(a) above) as a valid equitable mortgage. For the argument that, as a consequence of this, informal mortgages are “really” agreements to mortgage, and hence must now comply with s. 2 of the 1989 Act, see J. Howell, *Informal Conveyances and Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989* [1990] Conv. 441.

<sup>21</sup> Finance Act 1971, s. 64.

<sup>22</sup> In 1973 the fee for registering a mortgage where the application accompanies an application for registration of a transfer for value was reduced from half the *ad valorem* fee to nil: Land Registration Fee Order 1973, S.I. 1973, No. 1009, para. 2, now contained in the Land Registration Fees (No. 2) Order 1990, S.I. 1990, No. 2029, Sched. 4, Pt. 1, Abatement 1. There has always been an abatement from payment of fees where the application for registration of the mortgage accompanies an application for first registration of title: see now Abatement 1 of the 1990 Fees Order.

legal mortgage over a legal estate are presumably either to avoid the formality of a deed, or, in registered land, to avoid having to describe the mortgaged land in detail sufficient to satisfy section 25(2)(a) of the Land Registration Act 1925.

2.9 In the Working Paper<sup>23</sup> we described a third category of equitable mortgage: the mortgage by deposit of title deeds, whereby an equitable mortgage is created by the mortgagor merely depositing the title deeds of the mortgaged property with the mortgagee with the intention of creating a security. This method of creating an equitable mortgage of an interest in land has been removed by section 2 of the Law of Property (Miscellaneous Provisions) Act 1989.<sup>24</sup> This is because such a mortgage has traditionally been regarded as an agreement to mortgage, made enforceable despite failure to comply with section 40 of the Law of Property Act 1925 because the act of depositing the title deeds was deemed to constitute a sufficient act of part performance of the agreement.<sup>25</sup> As we explained in paragraph 2.8(a) above, section 2 of the 1989 Act now requires all agreements for the disposition of an interest in land (which includes agreements to mortgage) to be made in writing signed by both parties to the agreement and incorporating all the terms expressly agreed by them. Agreements to mortgage can therefore no longer be made orally: they must all satisfy the requirements of section 2 of the 1989 Act.<sup>26</sup>

#### *Equitable mortgage of an equitable interest*

2.10 A mortgage of an equitable interest is necessarily equitable. It can arise accidentally or be created deliberately:

- (a) *Accidental creation.* The most important example of this is where a mortgagor purports to create a legal mortgage, but does not have, or does not have the power to charge, a legal estate. In such circumstances the purported legal mortgage takes effect as an equitable mortgage of any equitable interest the mortgagor has in the land in question.<sup>27</sup> It most often occurs when one of two joint holders of a legal estate purports to create a legal mortgage by pretending to be solely entitled, or by forging or obtaining by improper means the co-owner's signature.
- (b) *Deliberate creation.* If created deliberately, an equitable mortgage of an equitable interest takes the same form (and is governed by the same principles) as a mortgage of chattels or choses in action: that is, it consists of an assignment of the mortgaged interest to the mortgagee with a proviso for re-assignment on repayment. Where the mortgaged property is an interest in land, the assignment must be in writing and signed by the mortgagor or mortgagor's agent.<sup>28</sup>

2.11 Whether the equitable mortgage of an equitable interest comes into existence accidentally or deliberately, it is quite different in nature from an equitable mortgage of a legal estate. In an equitable mortgage of a legal estate, the mortgagee is treated in equity as if he had a legal mortgage (that is, as if he had the leasehold interest he would have had if he had taken a mortgage by demise or a charge by way of legal mortgage). In an equitable mortgage of an equitable interest, on the other hand, the mortgagee holds the mortgaged equitable interest, subject to the mortgagor's equity of redemption.

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<sup>23</sup> Para. 3.13.

<sup>24</sup> Assuming that mortgages by deposit are technically agreements to mortgage and not equitable charges: see n. 26 below.

<sup>25</sup> *Russel v. Russel* (1783) 1 Bro. C.C. 269.

<sup>26</sup> It is arguable that oral mortgages by deposit of title deeds are technically not agreements to mortgage but equitable charges. This is because the traditional rationale (i.e. that deposit of title deeds is part performance of an agreement to mortgage) has never explained satisfactorily why no writing is required. The problem is that, even if there is an agreement to mortgage, it is the borrower and not the lender who is performing his part of the agreement by depositing the title deeds. Since it is fundamental to the doctrine of part performance that the person seeking to enforce the agreement may rely only on his own performance of it (G. Treitel, *The Law of Contract* (7th ed., 1987) pp. 144–146), this does not explain why mortgagees can enforce mortgages by deposit. For this reason, it may be more accurate to describe the oral mortgage by deposit as a species of equitable charge, and not an agreement to mortgage (and therefore not affected by s. 2 of the 1989 Act). However, there are difficulties with this argument (for example, there is no obvious reason why the charge is not invalidated by failure to comply with s. 53(1)(a) of the Law of Property Act 1925), and it is probably too late to raise it now, in the light of the long acceptance of the traditional view (the conclusion reached by the Supreme Court of Victoria when the argument was raised there: *Francis v. Francis* [1952] V.L.R. 321).

<sup>27</sup> Through the operation of s. 63 of the Law of Property Act 1925, or through the equitable principle of partial performance: *First National Securities Ltd. v. Hegerty* [1985] Q.B. 850 (C.A.); *Thames Guaranty Ltd. v. Campbell* [1985] Q.B. 210. See also *Ahmed v. Kendrick* (1988) 56 P. & C.R. 120.

<sup>28</sup> Law of Property Act 1925, s. 53(1)(a).

### *Equitable charge*

2.12 Equitable charges can be created consensually over any legal or equitable interest in land. The charge must be made in writing<sup>29</sup> but no other formality or particular form of words is necessary: the only requirement is that the parties demonstrate an intention to make the property “liable, or specially appropriated, to the discharge of a debt or some other obligation”.<sup>30</sup> There is a clear theoretical distinction between an equitable mortgage and an equitable charge, and they are different in effect, although often confused in practice. We return to this point in paragraph 2.14 below.

### *Reduction in number of types of security*

2.13 Whilst this proliferation of types of security interests 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 problem with equitable security interests in a legal estate is rather different. The principle underlying the equitable mortgage of a legal estate is the rule in *Walsh v. Lonsdale*,<sup>31</sup> a general property law principle which applies to mortgages in precisely the same way as it applies to fees simple, leases and easements. Nevertheless, if the equitable charge is included, it does mean that there are at least three, and possibly four,<sup>32</sup> ways of taking an informal security over a legal estate. Whilst there are small differences in effect between these different types of equitable security,<sup>33</sup> there is no apparent difference in function: none seems to fulfil a function that could not be fulfilled by any one of the others.<sup>34</sup> The same can be said of the different ways of taking security over equitable interests in land: response to the Working Paper confirmed that the differences in form and effect between equitable mortgages and equitable charges are regarded as of no practical significance. Finally, there is the question of whether it remains necessary for the method for 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 Paper 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. This view was challenged by some of our respondents. We consider these arguments below.<sup>35</sup>

### *Removal of the distinction between mortgages and charges*

2.14 A mortgage is conceptually different from a charge: a mortgage involves some degree of transfer of the mortgaged property to the mortgagee, with a provision for re-transfer on repayment of the loan, whereas a charge merely gives the chargee a right of recourse to the charged property as security for the loan.<sup>36</sup> 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.<sup>37</sup> 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 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.<sup>38</sup>

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<sup>29</sup> *Ibid.*

<sup>30</sup> Fisher and Lightwood, *op. cit.*, p. 15.

<sup>31</sup> (1882) 21 Ch.D. 9: where a grantor has entered into an agreement with a grantee to grant the grantee an interest in land, and the circumstances are such that the court would order specific performance of the agreement against the grantor, then the grantee is treated in equity as if he already holds the interest in land he would have if specific performance was ordered. For a full analysis of the doctrine see R. P. Meagher, W. M. C. Gummow and J. R. F. Leane, *Equity—Doctrines and Remedies* (2nd ed., 1984) paras. 235–44.

<sup>32</sup> See n. 26 to para. 2.9 above.

<sup>33</sup> Explained in paras. 3.72 and 3.73 of the Working Paper.

<sup>34</sup> If anything, lenders appear to regard the different levels of formality necessary to create different types of equitable security as a nuisance rather than an advantage.

<sup>35</sup> See paras. 2.25 *et seq.* below.

<sup>36</sup> E. I. Sykes, *The Law of Securities* (4th ed., 1986), Chs. 1 and 24; R. E. Megarry and H. W. R. Wade, *The Law of Real Property* (5th ed., 1984), p. 914; Fisher and Lightwood, *op. cit.*, pp. 4–5. For clear judicial analysis of the distinction see in particular *Swiss Bank Corporation v. Lloyd’s Bank Ltd.* [1982] A.C. 584, 594–6 *per* Buckley L.J.

<sup>37</sup> See the examples given in Fisher and Lightwood, *op. cit.*, p. 5.

<sup>38</sup> Megarry and Wade, *op. cit.*, p. 926; Sykes, *op. cit.*, Ch. 1.

2.15 The greatest potential for confusion between mortgages and charges arises in relation to equitable mortgages and charges of a legal estate. An equitable mortgagee is entitled to call for a legal estate, to foreclose, and possibly to take possession, whereas an equitable chargee has none of these rights. For this reason it may be important to distinguish the two, yet frequently the distinction is not observed.<sup>39</sup>

2.16 We have no evidence that this confusion between mortgages and charges has ever caused any significant problems in practice, and no reason to believe that it will do so in the future. Nevertheless, it is an additional complication in the law that serves no useful purpose and ought to be removed. Since the two concepts appear to have grown together in our jurisdiction, the most convenient course would seem to be to amalgamate them.

### **Inappropriateness of form**

2.17 The second root cause of the artificiality and complexity of mortgage law is that the methods used to create security interests in land give rise to inappropriate relationships between the parties. This is particularly apparent in the mortgage by demise and the mortgage by assignment.

#### *Mortgage by demise*

2.18 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,<sup>40</sup> and the equitable mortgage of a legal estate, which is treated in equity as if it were a legal mortgage, and hence a mortgage by demise.<sup>41</sup> 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 development or investing in non-residential land.<sup>42</sup> However, in the case of the mortgage by demise the leasehold relationship is the wrong way around: as tenant, the mortgagee has an inherent right to possession<sup>43</sup> 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 to the mortgagee to keep the property repaired and insured, yet this is a duty more usually imposed by a landlord on a tenant, rather than by a tenant on a landlord. Even if reversed, the landlord-tenant relationship is fundamentally different from that created by a mortgage: investors under a lease-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 performance of an obligation, and the value of the mortgagee's interest can never exceed 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 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 lease and mortgage by continuing to define one device in terms of the other.

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<sup>39</sup> See for example *Thames Guaranty Ltd. v. Campbell* [1984] 3 W.L.R. 109, 117 and 119-120 *per* Mann J. (at first instance) and at pp. 128-9 *per* Slade L.J. (in the Court of Appeal); *First National Securities Ltd. v. Hegerty* [1984] 3 W.L.R. 769, 779; *Cedar Holdings Ltd. v. Green* [1981] Ch. 129, 142-3; *In re Wallis & Simmonds (Builders) Ltd.* [1974] 1 W.L.R. 391.

<sup>40</sup> Law of Property Act 1925, s. 87.

<sup>41</sup> Para. 2.8 above. For a full discussion see H. W. R. Wade, *An Equitable Mortgagee's Right to Possession* (1955) 71 L.Q.R. 204.

<sup>42</sup> The preference for lease-based rather than mortgage-based arrangements is probably dictated largely by fiscal considerations, but may also be influenced by uncertainty and inflexibility in mortgage law, particularly in relation to profit-sharing provisions. There is some evidence of scope for a wider use of mortgages: A. J. P. McIntosh, *Funding Hi-Tech Industrial Property* (1984) 269 E.G. 710. See also N. W. Bowie, *Investing in Retailing* (1984) 271 E.G. 1064 (long-lease method of financing retail developments "so often restricts, slows down or prevents essential up-dating of centres and buildings"). In personal property, the shortcomings of the mortgage as a financing device are even greater: P. R. Wood, *Law and Practice of International Finance* (1980), Ch. 15.

<sup>43</sup> The mortgagee, as "tenant" also has an inherent right to sub-let although this is modified by Law of Property Act 1925, s. 99.

### *Mortgage by Assignment*

2.19 This is the only method available for creating a mortgage, as opposed to a charge, of an equitable interest in land. The mortgage by assignment is the mortgage in its purest (or, depending on one's point of view, most primitive) form.<sup>44</sup> The obvious theoretical objection to it is that it gives the mortgagee too great an interest in the mortgaged property at the outset, so the balance has to be redressed by a structure of rules curbing the mortgagee's exercise of ownership-type rights. A rather different objection to it in this context is that whilst it has long ceased to be used as a method of mortgaging legal estates in land,<sup>45</sup> it remains the principal method of mortgaging chattels and choses in action.<sup>46</sup> In the Working Paper we invited comments on whether there were any advantages in continuing to treat mortgages of equitable interests in land as if they were mortgages of personal property, rather than assimilating them into the law applicable to mortgages of legal estates. None of those who responded showed any great enthusiasm for the mortgage by assignment *per se*. Nevertheless, a minority argued strongly that equitable interests in land are more properly regarded as interests in funds rather than interests in land, and that therefore mortgages of equitable interests in land should continue to be governed by personal property rather than real property rules. We consider this argument, and our reasons for rejecting it, in paragraphs 2.25 to 2.30 below.

### **The Working Paper Proposals**

2.20 The radical proposal we made for tackling these fundamental problems, described as Proposal I in the Working Paper, was that all existing methods of mortgaging and charging interests in land should be abolished, and that new forms of mortgage, the formal land mortgage and the informal land mortgage, should be created for use over any interest in land. This was our preferred solution, and the solution preferred by the majority of those who responded, and it is the one we now recommend. Before explaining this recommendation in detail we should first make it clear why we reject the alternative proposals we put forward as Proposals II, III and IV.

### *Reasons for rejecting Proposals III and IV*

2.21 Proposals III and IV can be dealt with quite shortly. Proposal III was a watered-down version of Proposal I. It was that the mortgage by demise should be abolished, and the remaining methods of mortgaging and charging interests in land should be rationalised. In particular, this would be done by re-defining the charge by way of legal mortgage to incorporate most of the features suggested for the formal land mortgage, simplifying the methods of creating equitable securities over a legal estate, and assimilating equitable mortgages and equitable charges. We share what appeared on consultation to be the general view: Proposal III would produce no significant overall benefit and should be rejected. It would cause fairly major disruption to introduce such changes, and this would not be justified by the relatively minor simplifications the changes would achieve. As we pointed out in paragraph 7.1 of the Working Paper, the essence of Proposal III is that much of the present sub-stratum of the law would be retained, and this necessarily involves also retaining much of its complexity.

2.22 Proposal IV was that there should be no change in the existing structure of mortgage law, but that some of the suggestions made in relation to the new land mortgages (for example, about registration, priority, standard forms and standard terms) should be adopted and applied to existing types of mortgage. On consultation, as perhaps was to be expected, virtually the only support for Proposal IV came from those who preferred no change at all to be made in the law, but took the view that if changes had to be made, Proposal IV was the least undesirable of the proposals put forward. We believe that structural reform is necessary, and we therefore reject Proposal IV.

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<sup>44</sup> E. I. Sykes, *The Law of Securities* (4th ed., 1986) p. 14 describes it as "the most primitive and, having regard to the purposes of a security, the most inelegant form of security".

<sup>45</sup> Since 1925, a purported mortgage by assignment of a legal estate takes effect as a mortgage by demise: Law of Property Act 1925, ss. 85(2) and 86(2).

<sup>46</sup> Which perhaps explains why mortgages of chattels are relatively rare: for a discussion of the reasons why it is usually considered preferable to use other financing devices for raising money on chattels, see P. R. Wood, *Law and Practice of International Finance* (1980), Ch. 15.

### *Reasons for rejecting Proposal II*

2.23 The arguments for preferring Proposal II to Proposal I are stronger and merit closer attention. Proposal II differed from Proposal I only in that it confined the use of the formal and informal land mortgage to legal estates in land, preserving the existing methods of mortgaging and charging equitable interests (with some relatively minor reforms in relation to their protection, priority, and enforcement). A significant number of those who on consultation advocated radical reform, and agreed that the most effective way of achieving it would be the introduction of the new form of mortgage to replace existing mortgages and charges, nevertheless, preferred Proposal II to Proposal I. This was not because they thought it would be simpler: we do not think there is any serious disagreement with the view we expressed in the Working Paper that Proposal I is the simplest and neatest solution to the problems that are generally agreed to exist.

2.24 Broadly, two arguments for preferring Proposal II to Proposal I were put forward. The first is that the preservation of the equitable mortgage and charge is essential to the operation of the usual form of bank debenture, and so its abolition would inhibit or complicate secured lending to companies. We believe this argument is based on a misunderstanding of the way in which formal and informal land mortgages would work. The elements in a standard form of bank debenture which are causing concern are floating charges and charges over future property, and we are satisfied that they can continue to operate within the new system we recommend in the same way as they operate at present. We explain how we think this will work in Appendix G to this Report.

2.25 The second argument is more substantial. It is that equitable interests in land are different in nature from legal estates and interests, in that they are essentially interests in funds rather than interests in the land itself.<sup>47</sup> Because of this difference, it is argued, it is inappropriate to mortgage them in the same way as legal estates are mortgaged since provisions governing such matters as their registration, or powers of the mortgagee to preserve the security, will necessarily be quite different. We see the force of the argument that mortgages of equitable interests should not be forced into an inappropriate framework simply for the sake of neatness. However, we do not think that this is a necessary consequence of Proposal I.

2.26 It must be appreciated that this traditional view of the nature of equitable interests in land applies only to what is now a comparatively small group of equitable interests in land. For these purposes it is necessary to distinguish two different classes of equitable interest. The first class consists of interests of beneficiaries under a trust of land: these we refer to as "trust equitable interests". The second class consists of interests existing by virtue of a contractual right to acquire a legal estate: these include estate contracts, options to purchase and rights of pre-emption,<sup>48</sup> and we refer to them here as "commercial equitable interests". The traditional view that equitable interests are interests in funds rather than interests in land has no application whatsoever to commercial equitable interests: they are all indisputably interests in land. Trust equitable interests may be interests of beneficiaries successively interested in a trust fund, but it would be inappropriate and it would introduce complexity to draw a distinction between interests in possession and interests in remainder or reversion. Land held on trust may be sold pursuant to a trust for sale or power of sale, but unless and until it is sold and subject only to the doctrine of conversion, where applicable, the beneficiaries have their interests in land. However, the interests that form the vast majority of trust equitable interests are the equitable interests that exist under the trust for sale that arises automatically in all co-ownership cases. Whether these interests are properly regarded as interests in land, as distinct from interests in the proceeds of sale, has been a matter of long and serious controversy. This is a matter we considered in our Report on Trusts of Land,<sup>49</sup> where we recommended that the doctrine of conversion should no longer apply to trusts of land and that the interests of beneficiaries under a trust of land should remain interests in land until

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<sup>47</sup> The view that the interests of beneficiaries are essentially interests in a fund is best explained in F. H. Lawson and B. Rudden, *The Law of Property* (2nd ed., 1982) pp. 38–39.

<sup>48</sup> To the extent that rights of pre-emption survive as proprietary interests following the Court of Appeal decision in *Pritchard v. Briggs* [1980] Ch. 338.

<sup>49</sup> (1989) Law Com. No. 181.

sale actually takes place.<sup>50</sup> However, even in advance of implementation of this recommendation, we consider that it remains artificial to regard interests under most modern trusts for sale as interests in funds rather than interests in the land itself.

2.27 We have considerable reservations about the argument that equitable interests are essentially interests in funds, and therefore should not be mortgaged in the same way as interests in land are mortgaged. We consider that the argument is at its strongest in relation to the interests of beneficiaries in what may be called a mixed fund, in other words under a trust where the trust fund is held mainly for investment purposes, and may or may not include land at any one time, depending on how the trustees choose to exercise their investment powers. However, even these interests can, we believe, be brought within the land mortgage system without causing insuperable problems, provided that the status of the mortgage is apparent to the mortgagee's legal advisers at the time the mortgage is created. The only difficulty that we can foresee is in the case of a mortgage that changes status after it has been created (for example, because the trustees add land to a trust fund formerly comprising only personal property, or dispose of the only remaining land in the fund). We consider that the mortgagee of the interest of a beneficiary in such a fund can be expected to be aware of the need to ensure that, if there is a possibility that the fund may include land at any time, the mortgage complies with the formal requirements necessary to create a land mortgage.<sup>51</sup> However, compliance with registration requirements would pose greater problems, since the mortgagee would not necessarily know whether the fund included land at any stage. Subject to the question of registration, therefore, we are satisfied that Proposal I should be extended to mortgages of all interests in land.

2.28 We regard this conclusion as confirmed by what has happened to statutory charges over interests in land. It is now common practice for statutory charges to be made capable of attaching to any legal or equitable interest in land. Most notably, charging orders made under the Charging Orders Act 1979 can attach to any legal or equitable interest in land, including reversionary and remainder interests under a Settled Land Act settlement, and interests of beneficiaries under a trust for sale.<sup>52</sup> We are not aware of this having caused any problems (except in relation to registration, a matter we return to in the next following paragraph) and we do not believe it will do so in relation to formal and informal land mortgages.

2.29 It will be apparent from the preceding paragraphs that we think mortgages of trust equitable interests may, at least temporarily, require special treatment in relation to registration. In principle, we believe that mortgages of trust equitable interests can and should be brought within the registration regime we recommend for all other formal and informal mortgages. However, for reasons more conveniently explained in Part IV of the Report (where we deal with protection and priority in detail) it may not be feasible to do so until changes have been made in the registration rules presently applicable to statutory charges, and to those governing security interests in property other than land. However, we do not regard this as detracting significantly from the attractions of making trust equitable interests mortgageable only by formal and informal land mortgages.

2.30 In summary, we are not convinced by either of the arguments put forward for preferring Proposal II to Proposal I. Accordingly we recommend that the formal and informal land mortgages should replace all existing methods of consensually mortgaging or charging any legal or equitable estate or interest in land.

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<sup>50</sup> (1989) Law Com. No. 181, paras. 3.5 to 3.7. Under the new trust we recommend should be introduced the duty to sell and power to postpone sale would be replaced by a power to retain and a power to sell, although it would still be possible for a duty to sell to be imposed expressly. Our recommendation was, however, that the doctrine of conversion should be abolished in relation to all trusts, whether there was a duty or a power to sell, and that the interests of beneficiaries should remain interests in land until sale even where there was an express imposition of a duty to sell.

<sup>51</sup> As we explain in paras. 3.5 and 3.15 to 3.17 below the only formal requirements we recommend are that the mortgage should be made by deed if it is to be a formal land mortgage, and should be by deed or in signed writing satisfying s. 2 of the Law of Property (Miscellaneous Provisions) Act 1989 if it is an informal land mortgage. We would expect most mortgages of interests in such funds to be formal land mortgages, and we suspect they are already made by deed.

<sup>52</sup> Charging Orders Act 1979, s. 2.

## PART III

### FORMAL AND INFORMAL LAND MORTGAGES

#### Nature of the New Mortgage

3.1 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. It is also important that our reform should bring together in a single enactment the rules which govern the relationship between mortgagor and mortgagee. This will be particularly useful in commercial transactions. In such cases the parties often wish to negotiate detailed terms to fit the particular circumstances, and that makes essential a knowledge of the parameters which the law lays down.

3.2 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.

#### *Variable and overriding provisions*

3.3 We consider in Parts VI and VII of this Report the rights, powers, duties and obligations the mortgagor and mortgagee ought to be given by statute in order to ensure that the interest of the mortgagee is appropriate for these purposes. Most of these follow the proposals we made in Proposals I and V of the Working Paper, modified in some respects in the light of responses to that paper. It is envisaged that the parties to the new mortgage may want to extend or vary these statutory provisions by giving the mortgagee additional or different rights or powers. We take the view that as a matter of principle the parties should be free to make whatever bargain they choose, subject to two limitations. The first is that the essential nature of the mortgage ought to be preserved: if the parties want to give a lender rights in the borrower's property which are significantly greater than or different from those necessary to make the property available as security, then a mortgage is not an appropriate mechanism for them to use.<sup>1</sup> The second is that the parties should not be permitted to contract out of provisions designed to protect those mortgagors who are especially vulnerable. In order to achieve this we recommend that the statutory provisions should be divided into three classes: those in the first class should be freely variable; those in the second class should be overriding (by which we mean not variable at all); those in the third class should be variable in some mortgages but overriding in others. We consider it important that the statute should contain a clear explanation of what is meant by "variable" and "overriding". In particular, we recommend that it should be provided that:

- (a) variable provisions can be varied or excluded, either directly by express term in the mortgage deed, or indirectly by necessary implication from any express term; and
- (b) overriding provisions apply notwithstanding any provision to the contrary contained in the mortgage or in any other written or oral agreement; and
- (c) any provision of a mortgage or any other written or oral agreement is void to the extent that it (i) purports to impose a liability which has the effect of allowing the mortgagee to escape or mitigate the consequences of an overriding provision, or to be reimbursed or otherwise compensated for the cost of complying with it or (ii) has the effect of preventing or discouraging the mortgagor or any other person from enforcing or taking advantage of an overriding provision.

We consider which provisions should be variable and which overriding in Parts VI and VII of this Report.

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<sup>1</sup> Among the alternatives available, and already much used, are: joint venture agreements, lease-back or lease and sub-lease arrangements and share options. In these cases, it is appropriate for the parties to provide, if that is the bargain they have made, that the one providing the finance should share in the equity profit.



### *General limitation on exercise of mortgagee's rights, remedies and powers*

3.4 There is a further measure we recommend should be adopted in order to ensure that the parties can be given the maximum freedom of contract within the limitations we describe in the preceding paragraph. We recommend that the legislation should provide that the rights, remedies, and powers of the mortgagee under a formal and informal mortgage, whether derived from statute, contract, or elsewhere, are exercisable only in good faith and for the purposes of protecting or enforcing the security.<sup>2</sup> As a general limitation on the mortgagee's freedom of action, this has the considerable advantage of providing a check on improper or oppressive conduct without in any way interfering with the activities of reputable mortgagees.<sup>3</sup>

### **Method of Creation**

#### *Formal land mortgage*

3.5 In considering what formalities should be necessary in order to create a formal land mortgage, the principle we have adopted is that formal requirements ought to be kept to a minimum commensurate with requirements for the creation of other commercial interests in land, and that it ought not to be more difficult to create a formal land mortgage than it is to create a charge by way of legal mortgage in the present law. Formal requirements for the creation of a charge by way of legal mortgage are that it should be made by deed,<sup>4</sup> and that it should be expressed to be by way of legal mortgage.<sup>5</sup> To ensure consistency with the requirements for the creation of other interests in land, we consider that all formal land mortgages ought to be made by deed. In the interests of uniformity and simplicity, this should apply to formal land mortgages of equitable as well as legal interests, even though this represents an increase in the formalities presently required for mortgages of equitable interests. Whilst we consider that, as a mortgagor protection measure, some mortgages should be in a prescribed form and contain prescribed information (a point we return to in paragraph 3.7) we can see no reason why any particular form of words should be necessary in order to create a valid formal land mortgage, provided the parties evince an intention to make the mortgaged property security for performance of the mortgagor's obligations. Accordingly, we recommend that, in order to be valid, a formal land mortgage must be made by deed, whether it is of a legal estate or an equitable interest, but that no particular form of words should be necessary, other than those necessary to constitute a deed.

3.6 We should mention at this point that we recommend below<sup>6</sup> that informal mortgages should be recognised, and that the consequence of failure to comply with the formal requirements for creation of a formal land mortgage should be that the mortgage takes effect as an informal mortgage (provided it is in signed writing satisfying the requirements of section 2 of the Law of Property (Miscellaneous Provisions) Act 1989). There is no question, therefore, of a mortgage being void simply because any formalities (other than these section 2 formalities) are not observed.

3.7 We have already referred to the recommendation we make in Part V of this Report that some mortgages (the protected mortgages discussed in Part IV of the Report) should be in a prescribed form and contain prescribed information. We did consider whether the sanction for failure to comply with these requirements should be that the mortgage does not take effect as a formal land mortgage. We rejected this, partly out of a desire to keep formalities for creation to a minimum, but mainly because we are satisfied that compliance

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<sup>2</sup> It has been said that such a principle already forms part of English law: *Quennell v. Maltby* [1979] 1 W.L.R. 318, 322–3 *per* Lord Denning M.R. but the correctness of this view has been challenged: see J.S. Fisher (1979) 123 Sol. Jo. 775, M. Davey (1983) 127 Sol. Jo. 431, and n. 27 to para. 6.16 below.

<sup>3</sup> There is a similar provision in the Merchant Shipping Act 1894 which has long been held to restrict the exercise of the rights and remedies of ship mortgagees in this way: s. 34 provides that "Except as far as may be necessary for making a mortgaged ship or share available as a security for the mortgage debt, the mortgagee shall not by reason of the mortgage be deemed the owner of the ship or share, nor shall the mortgagor be deemed to have ceased to be owner thereof" (see Temperley, *Merchant Shipping Acts* (7th ed., 1976) annotations to s. 34 of the 1894 Act). The USA Uniform Land Security Interest Act approved by the National Conference of Commissioners on Uniform State Laws in 1985 contains a similar blanket good faith provision applicable to all land mortgages: "108 **Obligation of good faith** Every contract or duty governed by this Act imposes an obligation of good faith in its performance or enforcement."

<sup>4</sup> Law of Property Act 1925, s. 52.

<sup>5</sup> Law of Property Act 1925, ss. 85(1), 86(1) and 87(1).

<sup>6</sup> Paras. 3.9–3.10.

can be ensured just as effectively by making failure to comply affect enforcement of the security as by making it affect validity.<sup>7</sup> Consequently we recommend that a formal land mortgage should be validly created even if any requirements as to prescribed form and content are not observed.

3.8 Where the mortgagor's title to the mortgaged property is registered at H.M. Land Registry, we recommend that, as an additional requirement, the mortgage should not qualify as a formal land mortgage unless it is substantively registered against that title. In the present law, substantive registration is necessary for a mortgage by demise or charge by way of legal mortgage to be recognised as a legal mortgage.<sup>8</sup> This is part of the general Land Registration Act scheme that the status of registrable interests is affected by failure to register. It is therefore in keeping with land registration principles that a mortgage of a registered estate should be registered before it can qualify as a formal land mortgage. In order to be registrable the mortgage should, as in the present law, describe the land affected.<sup>9</sup> Until registration, the mortgage would take effect as an informal land mortgage.

#### *Recognition of informal mortgages*

3.9 In the Working Paper we raised the question of whether informal mortgages should be recognised at all. We repeat here what we said about the issue:

“5.4 *Should they be recognised?* In Scottish law, any attempt to create a security by any means other than (or falling short of the formal requirements for) the standard security is void. In other words, whilst the mortgagor remains personally liable to pay the debt or discharge the liabilities incurred, the mortgagee acquires no security (or other) interest in the property, and no right of recourse to it: see Conveyancing and Feudal Reform (Scotland) Act 1970, s. 9(4). Such a solution is technically feasible in English law. It has the attraction of simplicity and neatness, and it can be argued that it would cause no real hardships to mortgagees, who are, overwhelmingly, commercial organisations with access to competent legal advice. However, English law differs from Scottish law in that it has a long history of recognising and enforcing in equity property interests which for some reason such as lack of formality fail to acquire a legal status. Traditionally this has been utilised by lenders for the purpose of deliberately creating informal mortgages enforceable only in equity. We welcome views on whether there is still a demand for informal mortgages in this country. If, as we suspect is the case, there is such a demand we can see no compelling reason for failing to satisfy it, and we suggest that it could best be satisfied by making statutory provision for informal land mortgages.”

3.10 The responses we received did indeed reveal a significant demand for informal mortgages. However, concern was expressed by others that measures designed to protect borrowers by prescribing the form and content of some mortgages might be evaded by the deliberate use of informal mortgages. They argued that the only way to prevent this happening is to follow the Scottish example and provide that the consequence of failure to create a formal land mortgage is that no security is created. We take this argument seriously, but on balance we do not think it outweighs the considerable arguments in favour of recognising informal mortgages if, as we believe, it is possible to tackle the evasion problem by other means.<sup>10</sup> It is important to remember that the function of the informal land mortgage is not merely to cushion careless lenders who fail to observe the few simple formalities necessary to create a formal land mortgage. If informal land mortgages are recognised it will be possible for charges over future property and floating charges to continue to operate in relation to interests in land in much the same way as they do at present.<sup>11</sup> If they are not recognised, considerable changes will have to be made in at

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<sup>7</sup> Specifically, the court can be given the discretion to delay or refuse enforcement on the grounds that the mortgage was not in a prescribed form or did not contain prescribed information, or regulations about provision of copies were not observed (para. 5.12 below) and can be given a discretion exercisable on the same grounds to refuse (or grant subject to conditions) an order that an informal mortgage should be perfected by the grant of a formal mortgage (paras. 3.11 to 3.13 below). One of the advantages of dealing with it in this way is that it leaves the court free to ignore minor or immaterial breaches, and to make the sanction appropriate to the gravity of the breach.

<sup>8</sup> Land Registration Act 1925, s. 106(2) as substituted by the Administration of Justice Act 1977, s. 26(1).

<sup>9</sup> Land Registration Act 1925, s. 25(2)(a) and s. 26. In our Third Report on Land Registration, (1987) Law Com. No. 158, we recommended that this requirement should continue to apply to mortgages.

<sup>10</sup> As we explained in para. 3.6 above, we prefer what we see as the more flexible option of making failure to comply with mortgagor protection requirements affect enforcement (and, where appropriate, perfection) rather than status or validity of the security: see further paras. 3.11–3.13 and 5.12 below.

<sup>11</sup> See Appendix G to this Report.

least the documentation accompanying commercial borrowing. Whilst lenders could no doubt learn to live with this (as they have to in Scotland) we do not think a sufficient case for disrupting the system in this way has been made out. We therefore recommend that informal mortgages should be recognised.

#### *Nature of informal mortgage*

3.11 We remain of the view expressed in the Working Paper that the difference between formal and informal land mortgages should lie in the availability of rights of recourse to the security. We recommend that the informal mortgagee should have no right to enforce the security,<sup>12</sup> nor to take any other action in relation to the mortgaged property:<sup>13</sup> in order to enforce the security an informal mortgagee should first have to have the mortgage perfected (that is, to have a formal land mortgage granted to it).

3.12 In the case of those mortgages which do not fall within the specially protected class discussed in Part IV of this Report, we consider that an informal mortgagee should be entitled, but not required, to obtain the assistance of the court in order to perfect the mortgage. In other words, if such a mortgagee applied to the court to perfect the security, the court should be obliged to make an order for the execution of a formal mortgage to replace the informal mortgage, if satisfied that the applicant's informal mortgage is valid and subsisting.<sup>14</sup> However, such a mortgagee should not be obliged to apply to the court for perfection of the security, if able to perfect it by other means such as by use of a power of attorney. We understand that it is present practice to include an irrevocable power of attorney in equitable mortgages of commercial property, and in bank debentures, so that the mortgagee can execute a legal mortgage in its own favour as attorney for the mortgagor,<sup>15</sup> and enforce the security without the assistance of the court. We can see no reason why this practice should not be allowed to continue in the case of informal mortgages which are not within the protected class.

3.13 Different considerations apply to informal mortgages which fall within the protected class.<sup>16</sup> We have already referred to the recommendation we make in Part V of this Report that protected mortgages, whether formal or informal, should be in a prescribed form and contain prescribed information, and that the court should have a wide discretion as to the sanction to be imposed on a mortgagee who fails to comply with these requirements.<sup>17</sup> One of the sanctions we had in mind was that the court should have power to refuse (or grant only subject to conditions) an order that the mortgage be perfected. The effectiveness of this sanction would be undermined if a mortgagee was able to procure perfection of the security without the assistance of the court. Accordingly, we recommend that a protected informal mortgage should not be capable of being perfected except by court order, and that on an application by the mortgagee for perfection the court should have the powers explained in paragraph 5.12 below, but should have no other powers to refuse to make a perfection order if satisfied that the informal mortgage was valid and subsisting.<sup>18</sup> This should not result in a significant increase in the number of mortgages to be dealt with by the court, since we recommend in Part VII of this Report that a mortgagee should not be entitled to enforce a protected mortgage without first obtaining a court order, and we anticipate that most applications for perfection of an informal mortgage will be made as a preliminary step towards enforcement.

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<sup>12</sup> That is, should have no right to sell the whole or any part of the mortgaged property, or appoint a receiver or take possession of the whole or any part of it. In the present law, a mortgage may also be enforced by means of foreclosure, but we recommend in paras. 7.26–7.27 below that the remedy of foreclosure should be abolished.

<sup>13</sup> For example, the mortgagee should have no right to grant a lease of all or any part of the mortgaged property. Neither this nor the restriction explained in the previous footnote is intended to cover any non-proprietary rights or remedies the mortgagee may have: in particular, the informal mortgagee would remain free to enforce the mortgagor's personal covenant to pay sums due under the mortgage by bringing a personal action against the mortgagor.

<sup>14</sup> Unless such an order would be inappropriate in the light of any variation of the terms of the mortgage the court might make in exercise of the powers we recommend in Part VIII of this Report: we have in mind the possibility that a variation ordered by the court might result in the effective discharge of the mortgage (for example the court might strike out a contractual prohibition on redemption, or alter money payments so that no further sums are due under the mortgage), in which case conversion of the mortgage to a formal mortgage would clearly be inappropriate.

<sup>15</sup> We explain this in more detail in Appendix G to this Report.

<sup>16</sup> Para. 4.6 below.

<sup>17</sup> See paras. 3.6 above and 5.12 below. For precise details of these requirements, which cover provision of copies of the mortgage as well as requirements as to form and content, see paras. 5.9–5.11 below.

<sup>18</sup> Unless discharge of the mortgage was imminent, for the reasons explained in n. 14 above.

### *Method of Creating Informal Land Mortgage*

3.14 In principle, we consider that informal mortgages should be recognised in the same circumstances as informal securities are now recognised. More specifically, we recommend that any purported consensual security over any interest in land that does not constitute a formal land mortgage but would, in the present law, give rise to an equitable mortgage or charge, should take effect as an informal land mortgage, provided it complies with the appropriate formal requirements. This is in accordance with the provisional view we expressed in the Working Paper, which received broad support. We consider what formal requirements are appropriate in the following paragraphs.

3.15 When the Working Paper was published, it was still possible<sup>19</sup> to create an equitable mortgage by mere deposit of title deeds, without the use of any writing. As we explained in paragraph 2.8 above, this is no longer possible. Equitable mortgages of a legal estate are now void unless made in writing satisfying the requirements of section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 (if technically agreements to mortgage) or of section 53(1)(a) of the Law of Property Act 1925 (if technically dispositions of an interest in land).<sup>20</sup> Equitable mortgages of an equitable interest, on the other hand, and equitable charges (whether of a legal or an equitable interest) are clearly dispositions of an interest in land and hence continue to be governed by section 53(1)(a) of the 1925 Act. Mortgages and charges governed by section 53(1)(a) of the 1925 Act must be made in writing signed by the mortgagor or a duly authorised agent, whereas those governed by section 2 of the 1989 Act must be made in writing signed by or on behalf of each party, and incorporating (either directly or by reference to another document) all the terms expressly agreed by the parties.

3.16 The provisional view we expressed in the Working Paper was that at least some writing should be required for the creation of all informal mortgages, and this view was confirmed on consultation. This is consistent with the abolition of oral mortgages brought about by section 2 of the 1989 Act. However, an important simplification that can be achieved under the new scheme we recommend is to make all informal mortgages subject to the same formality rules. It is clearly important that these rules should be consistent with those governing other interests in land, and in order to maintain consistency of practice and principle we recommend that, subject to the point made in the next paragraph, the rules should be the same as those set out in section 2 of the Law of Property (Miscellaneous Provisions) Act 1989. In other words, an informal land mortgage should be made in writing incorporating the terms expressly agreed by the parties (directly or by reference to one or more other documents) and signed by or on behalf of each party.

3.17 In the present law, it is possible for an equitable mortgage of a legal estate to be made by deed. There are circumstances in which it is more convenient for the parties to adopt the formalities necessary to create a valid deed rather than the lesser, but different, formalities necessary for compliance with section 2 of the 1989 Act.<sup>21</sup> We can see no reason why those who would prefer to adopt the same formalities as those necessary for the creation of a formal land mortgage should not be allowed to do so. Accordingly, we recommend that an informal land mortgage should either be made in writing satisfying the requirements of section 2 of the Law of Property (Miscellaneous Provisions) Act 1989, or should be made by deed.

### **Registration and Priority**

3.18 One of the attractions of the simplified mortgage structure outlined in the previous paragraphs is the opportunity it presents for rationalising the rules governing protection

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<sup>19</sup> Although unusual in practice.

<sup>20</sup> See paras. 2.7–2.8 above.

<sup>21</sup> For example, where equitable mortgages are created by a debenture deed. These include mortgages of legal estates where the mortgagor's title is registered at the land registry but the debenture contains insufficient details of the title to enable the mortgage to be substantively registered, and mortgages of after-acquired property: see Appendix G to this Report.

and priority of land mortgages.<sup>22</sup> In considering how these rules should be rationalised our starting point has been that, ideally, protection and priority of land mortgages should depend on registration. Most mortgagees are commercial organisations acting with the benefit of legal advice and it is reasonable to expect them to protect their interests by registration.<sup>23</sup> Also, the reaction to the proposals about registration we made in the Working Paper confirmed our impression that, on the whole, lenders would welcome the certainty of a uniform registration system. However, we recognise that there are difficulties in the way of achieving this ideal. The first is that we have to work within the limitations of our existing property registration systems. This means that, for registration purposes at least, it will remain necessary to distinguish between mortgages of legal estates and mortgages of equitable interests. Also, since mortgages do not exist in isolation from other interests in land, rules governing their priority must be consistent with priority rules governing other interests. A further limitation is that of resources. We are not in a position to give a reliable estimate of the total number of mortgages in existence at any one time, but at present it is almost certainly well in excess of eight million.<sup>24</sup> Given such large numbers, any increase in recording requirements is likely to have immediate resource implications for H.M. Land Registry and for lending institutions, although we would hope that in the longer term the expense and inconvenience would be justified by the benefits that can be expected to result from a simplification of the system.

3.19 With these limitations in mind, we think nevertheless it is possible to go a long way towards achieving a uniform registration system. In the following paragraphs we explain our proposals in relation first to registered then to unregistered land.

### **Protection and Priority in Registered Land**

#### *Formal land mortgage of a legal estate*

3.20 In principle, a formal land mortgage of a legal estate ought to be treated for the purposes of registration and priority in the same way as a mortgage by demise and charge by way of legal mortgage are treated in the present law. Accordingly, we recommend that a formal land mortgage of a legal estate should be substantively registrable, and that unless and until registered it should take effect as an informal land mortgage.<sup>25</sup> Once registered, it would constitute a registered charge for the purposes of the Land Registration Acts 1925 to 1988. As such, its priority would depend on the date of its registration.<sup>26</sup>

#### *Informal land mortgage of a legal estate*

3.21 In our Third Report on Land Registration<sup>27</sup> we considered the different forms of protection (as opposed to registration) presently available for mortgages and charges under the Land Registration Acts. We recommended that the primary methods of protection should be the notice and caution, and that protection by notice of deposit and notice of intended deposit should cease to be available. Although those recommendations were of course made in the context of the present law of mortgages, we believe they are equally applicable to the new mortgages proposed in this Report. Moreover, since such a simplified

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<sup>22</sup> We explained the problems in the law relating to protection and priority of mortgages in unregistered land in the Working Paper, paras. 3.10–3.22. In the following year we published our Third Report on Land Registration, (1987) Law Com. No. 158 in which, in the context of a review of all aspects of protection and priority of minor interests, we made detailed recommendations about the protection and priority of mortgages and charges in registered land (see Third Report, *Part IV: Protection and Priority of Minor Interests (And of Mortgages and Charges)*). For earlier considerations of mortgage protection and priority problems in this country see the Report of the Committee on Land Charges (1956) Cmd. 9825 (“The Roxburgh Report”), and our Report on Transfer of Land: Report on Land Charges Affecting Unregistered Land, (1969) Law Com. No. 18, and Transfer of Land: Land Registration (Fourth Paper), (1976) Working Paper No. 67.

<sup>23</sup> cf. para. 2.6 of our Third Report on Land Registration *ibid.*, where we consider the principles to be adopted in deciding whether the effectiveness of an interest as against third parties should depend on registration.

<sup>24</sup> The Building Societies Association estimates that there were 7,674,000 mortgages of residential property subsisting in 1989: *Social Trends 20* (1990, H.M.S.O.) p. 135. No figures are available to indicate the number of non-residential mortgages, but we assume there must be several million.

<sup>25</sup> It will be appreciated that under the Land Registration Acts estates capable of subsisting as legal estates are registrable, but until so registered take effect in equity only (Land Registration Act 1925, ss. 2 and 69). Once a mortgagor’s title (freehold or leasehold) has become registrable, it will not constitute a legal estate until it is registered. This means that in such circumstances it will not be possible to protect a formal land mortgage by registration unless and until the mortgagor’s title has been registered. The same is true of a mortgage by demise or charge by way of legal mortgage in the present law.

<sup>26</sup> Land Registration Act 1925, s. 29.

<sup>27</sup> (1987) Law Com. No. 158.

protection system would affect mortgages only and not other interests in land,<sup>28</sup> it is feasible to implement it as part of this exercise even if this has to be done in advance of the full implementation of the Third Report. Hence we repeat here the recommendations made in the Third Report and the reasons we gave for making them:

“4.75 Of the different forms of protection above mentioned, the important practical distinction between [substantive registration] and any other sort of registration should be noted. The distinction is that a chargee or mortgagee has the full range of legal rights and remedies and priority only when the charge is registered substantively. Any other sort of protection merely ensures that the charge is not void against or postponed to a subsequent purchaser of the estate affected.

4.76 That being the position . . . is it really necessary to have such a great variety of different forms of protection (other than registration) for mortgages and charges generally? . . .

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4.80 As to the . . . question raised in paragraph 4.76 [of the Third Report], we were pressed in the response to the Working Paper with the view that the commercial practice of the banks and building societies had adapted itself to the procedural quirks in the different forms of protection and that any disturbance risks causing more upheaval than it would be worth. We are sympathetic to this view, but we do not believe that it should prohibit simple and obvious reforms, particularly at a time when ways of simplifying the process of buying and selling generally are being sought.

4.81 In approaching this question, we think it helpful to recall the classification of the methods of protection proposed in paragraph 4.38 onwards of this Part of [the Third Report]. This provided that the choice of method was to be dictated by whether the registered proprietor acknowledged the interest to be protected or not. Applying this to the protection of charges still leaves two methods of protection available when, as is most often the case, the charge is acknowledged: the notice and the notice of deposit. We consider that the notice of deposit is foreign to the classification of methods of protection we have given. It is anomalous in that it is called a notice but operates as a caution. It does nothing that we have been able to discern—except trigger the “warning off” of a prior caution, and neither the value nor the purpose of this is clear to us—that a notice does not or could not do equally well. We therefore recommend that protection by notice of deposit should cease to be available. Similar reasoning applies to the notice of intended deposit. We understand that the notice of intended deposit was designed to meet the case where there was no certificate to be deposited, either because it had not yet been prepared or because it was not yet in the name of the depositor. Yet a legal charge of the land is often entered into by the purchaser before he is registered as proprietor (and therefore before he obtains the legal title) without apparent difficulty. So it ought to be with a deposit of a certificate. This change will involve a deposit under section 66 being achieved by a request to enter a notice and a direction to the Land Registry to send the certificate to the proposed deposit. In practice, where the same solicitor or other agent is acting for both proprietor and deposit, the request for the entry of notice will achieve the section 66 deposit. In consequence of this, we recommend the abolition of the notice of intended deposit.

4.82 Protection of mortgages and charges of whatever sort which affect the legal title will therefore be achieved either by notice or by caution, according to whether the mortgage or charge is acknowledged by the proprietor. We would qualify this in one respect. Where an unregistered charge or an informal mortgage is protected against a title otherwise free from incumbrances simply by a notice or a notice of deposit, this will mean that the land certificate is with such mortgagee or chargee. If the creation of a second mortgage or charge is later desired, then, although the registered proprietor accepts that it may be protected by notice, the production of the land certificate to the Land Registry is not a matter within his control. A second mortgagee might exceptionally therefore be constrained to protect by caution when his interest was not disputed. We therefore recommend that in this one instance a notice should be available, even though the land certificate is outstanding. It should be noticed that in the above example, were the first charge a registered charge, there would be no difficulty in protecting a second charge by notice without production of the charge certificate.”

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<sup>28</sup> In the present law, the only interests capable of protection by notice of deposit or notice of intended deposit are consensually created mortgages and charges: Land Registration Rules 1925, S.R. & O. 1925, No. 1093, r. 239.

The same considerations apply to the protection of informal land mortgages (at least where the mortgaged property is a legal estate). Accordingly, we make the same recommendations: we recommend that an informal land mortgage of a legal estate should be protected by notice where the informal land mortgage is acknowledged by the registered proprietor (acknowledgement being signified in the ways recommended in the Third Report); in all other circumstances an informal land mortgage should be protected by caution. We further recommend (again repeating recommendations made in the Third Report) that the notice of deposit and notice of intended deposit should be abolished.

#### *Priority of informal land mortgages of a legal estate*

3.22 It would be in accordance with the priority principles propounded in paragraph 3.18 above for priority of informal land mortgages protected on the register by notice or caution to depend on the date of protection. However, in the present law the entry on the register of a caution has no effect on the priority of the interest protected, and the same is probably true of a notice.<sup>29</sup> Instead, priority between minor interests (including all unregistered mortgages and charges) depends *prima facie* on their respective dates of creation, but this *prima facie* order is liable to be disrupted by the application of not wholly clear and consistent pre-twentieth century equitable rules requiring consideration of whether the 'equities' of the mortgagor and the mortgagee are equal.<sup>30</sup> In our Third Report on Land Registration we concluded that this was not a satisfactory way of dealing with priorities and we recommended that it should be replaced by "a self-contained, comprehensive scheme" in which priority of all minor interests would depend on date of protection by notice, caution, restriction or inhibition.<sup>31</sup> We remain convinced that this remains the best solution and we strongly urge that the recommended scheme should be put into operation as quickly as possible. Our only doubt is whether, pending full implementation, the scheme could be partially implemented to apply to mortgages only. The suggestion that partial reform on these lines might be feasible has already been canvassed. We first put it forward for consideration in 1976 in Working Paper No 67 Transfer of Land: Land Registration (Fourth Paper).<sup>32</sup> However, when we looked at the matter again in 1987 in our Third Report we concluded that it was not desirable:

"4.97 The Working Paper proposed that only financial charges should require to be noted in order to gain priority as against other protected minor interests. Such a proposal would, of course, leave a number of complicated issues concerning the relative priorities of unprotected interests. It would also have led to an additional set of legal rules which many institutional lenders who regularly lend on the security of registered or unregistered land might find a complication rather than a help. These considerations and our original unease about promoting a system which covered only certain minor interests have prompted us to look again at priorities. It seems to us that the only system that can be defended in the context of registration is that all minor interests, not merely financial ones, should rank for priority according to the date of their entry on the register."

Whilst we remain convinced of the benefits of the recommended scheme as far as priority of mortgages is concerned, we reach the same conclusion here as we did in 1987 about changing the rules for mortgages only whilst leaving all other minor interests subject to the present law. Accordingly, but with considerable regret, we recommend that, pending full implementation of the recommendations about priority of minor interests made in the Third Report, the priority of informal land mortgages protected by notice or caution should continue to be governed by the rules presently applicable to the priority of minor interests.

#### *Formal and informal mortgages of an equitable interest*

3.23 The question of how to provide for the registration or protection of mortgages of equitable interests within the confines of our registration of title system causes

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<sup>29</sup> *Barclay's Bank Ltd. v. Taylor* [1974] Ch. 137. It has been argued that in the present law notices, unlike cautions, may well have priority effect: R.J. Smith, *The Priority of Competing Minor Interests in Registered Land*, (1977) 93 L.Q.R. 541. For the opposite view, see para. 4.96 of the Third Report.

<sup>30</sup> P.V. Baker and P.St.J.H. Langan, *Snell's Principles of Equity* (29th ed., 1990) p. 58.

<sup>31</sup> (1987) Law Com. No. 158, para. 4.96.

<sup>32</sup> Working Paper No. 67 (1976), paras. 103 *et seq.* The suggestion was that the scheme should apply to "financial charges", i.e. not only consensual mortgages and charges but also charging orders made under the Charging Orders Act 1979 (replacing the Administration of Justice Act 1956, s. 35).

considerable difficulty.<sup>33</sup> If the ideal of a uniform registration system is to be achieved, such mortgages ought to be registrable at the Land Registry. The problem is that the Land Register is essentially a register of titles to *legal* estates in land: equitable interests are recorded only on the register of the legal title from which the equitable interest is derived. It follows that if a mortgage of an equitable interest is to be recorded anywhere on the Land Register, it must inevitably appear in the register of the underlying legal title.<sup>34</sup> This would be objectionable if such a mortgage was incapable of affecting the holder of the legal title: as a matter of principle, matters not affecting the legal title ought not to appear on the register of that title. The crucial question therefore is whether mortgages of equitable interests have sufficient potential effect on the underlying legal estate to justify their protection on the register of title to that legal estate.

3.24 For these purposes it is necessary to return to the distinction we made earlier between trust equitable interests (interests of beneficiaries under a trust of land) and commercial equitable interests (interests such as options to purchase and other estate contracts that arise by virtue of a contractual right to acquire a legal estate).<sup>35</sup> Recording mortgages of commercial equitable interests against the underlying title raises no theoretical problems. The commercial equitable interests most likely to be mortgaged are estate contracts (options to purchase, agreements for lease, contracts for purchase, etc.). The potential effect of such interests on the underlying legal estate is apparent, and unsurprisingly, the Land Registration Acts provide for their protection on the register of the title to the legal estate by entry of notice or caution.<sup>36</sup> If such an interest can itself properly appear on the register, there seems no objection in principle to a mortgage of such an interest also appearing.<sup>37</sup> Accordingly we recommend that both formal and informal land mortgages of commercial equitable interests should be protectable by entry of notice or caution.

3.25 The position is less straightforward in relation to mortgages of trust equitable interests. The original intention behind the Land Registration Act appears to have been that trust equitable interests should not appear anywhere on the register.<sup>38</sup> It was envisaged that, as in unregistered land, they would be overreached by any conveyance satisfying the requirements of the Law of Property Act 1925, section 2 (that is, payment of the purchase price to two or more trustees or a trust corporation). Hence, nothing need appear on the register other than, at most, a warning to prospective purchasers (in the form of a restriction<sup>39</sup> requiring payment of capital money to two or more trustees or a trust corporation) of the steps to be taken to overreach any trust equitable interests that may exist.

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<sup>33</sup> Although the difficulty is, we suspect, largely of theoretical rather than practical importance. In particular, we doubt whether mortgages of interests under a trust for sale of land (in relation to which the theoretical problems are at their most acute) are deliberately created in significant numbers. It is well documented that they can be, and are in practice, created inadvertently (e.g. *First National Securities Ltd. v. Hegerty* [1985] Q.B. 850 (C.A.): see further, para. 2.8 above) but presumably the numbers are not great, and in any event the circumstances are such that registration is unlikely. So, imposing a registration requirement would not have significant resource consequences, nor, it is thought, would it significantly worsen the predicament of the mortgagee in such circumstances, since his primary concern is enforcement of the security, rather than preservation of priority against third parties.

<sup>34</sup> Until 1986 an equitable interest could, in theory at least, have been registered in the Minor Interests Index. See Working Paper, para. 5.17 for the reasons why the Minor Interests Index was abolished by the Land Registration Act 1986, s. 5.

<sup>35</sup> Para. 2.26 above.

<sup>36</sup> By s. 59 Land Registration Act 1925 all interests registrable as land charges in unregistered land are protectable by notice or caution in registered land. Commercial equitable interests are estate contracts and hence registrable under the Land Charges Act 1972 as Class C(iv) land charges.

<sup>37</sup> There might be some objection if protection of the mortgage on the register resulted in the mortgaged interest itself becoming enforceable against a purchaser from the registered proprietor who would otherwise have taken free from the mortgaged interest. However, this is not the effect of a notice or caution, either under the present law or under the scheme proposed in our Third Report on Land Registration: see Land Registration Act 1925, s. 52(1):

“A disposition by the proprietor shall take effect subject to all estates, rights, and claims which are protected by way of notice on the register at the date of the registration or entry of notice of the disposition, **but only if and so far as such estates, rights, and claims may be valid and are not (independently of this Act) overridden by the disposition**” (emphasis added).

For the even more limited effect of a caution see *ibid.*, ss. 54, 55 and 56(2).

<sup>38</sup> Note in particular Land Registration Act 1925, s. 74:

“Subject to the provisions of this Act as to settled land, neither the registrar nor any person dealing with a registered estate or charge shall be affected with notice of a trust express implied or constructive, and references to trusts shall, so far as possible, be excluded from the register.”

<sup>39</sup> Under Land Registration Act 1925, s. 58 and, in the case of settled land, s. 86(3).



3.26 In practice this has proved inadequate, from the point of view of both purchasers from registered proprietors and beneficiaries of trusts of land. It does not ensure that purchasers are always alerted of the need to operate the overreaching machinery, and as a result neither purchasers nor beneficiaries are fully protected.<sup>40</sup> In particular, it has become apparent that beneficiaries under a trust for sale may need protection against improper dealings with the legal estate, and that this can be more appropriately provided by entry of a notice or caution rather than a restriction.<sup>41</sup> The general principle that trust equitable interests are kept off the register is, therefore, not universally applicable. Accordingly we are not convinced that there is any objection in principle to recording mortgages of trust equitable interests in the register by means of entry of a notice or caution against the title of the underlying legal estate.

3.27 Unfortunately, whilst there may be no objections in principle, there are practical reasons why it may not be feasible to introduce such a change into the system at this stage. The first is that as a result of the decision in *Perry v. Phoenix Assurance plc*<sup>42</sup> a charging order made on a beneficial interest under a trust for sale of land (under section 2 of the Charging Orders Act 1979) is not registrable as a land charge under the Land Charges Act 1972 in unregistered land, and therefore cannot be protected by notice or caution in registered land.<sup>43</sup> The question of whether charging orders (and other statutory charges) over trust equitable interests ought to be brought within the registration systems in both registered and unregistered land is outside the scope of this Report. Given the present state of the law, however, we are reluctant to recommend the adoption of protection and priority rules that would result in consensual security interests being governed by protection and priority rules different from those governing non-consensual charges.

3.28 The second reason why a change in the way of dealing with mortgages of trust equitable interests may be premature lies in the problem of mixed funds we referred to in paragraph 2.27 above. By a mixed fund we mean a trust where the trust property is held primarily for investment purposes, and may or may not include land at any one time, depending on how the trustees choose to exercise their powers of investment. As we explained in paragraph 2.27 above, it is not feasible to require a mortgagee of the beneficial interest in such a fund to comply with registration requirements as and when land is added to the fund after the creation of the mortgage and without the knowledge of the mortgagee. The best solution to this problem would seem to be to make mortgages of interests in mixed funds registrable, but not as land mortgages. In his Report, *A Review of Security Interests in Property Other Than Land*<sup>44</sup> Professor Diamond recommended that all security interests over interests in property other than land should be registrable by a system of notice filing. Such a system would provide an appropriate way of dealing with the protection and priority of mortgages of interests that may change in character during the currency of the mortgage,<sup>45</sup> and would subject such mortgages to protection and priority rules harmonising with those we recommend should apply to land mortgages.<sup>46</sup> We would therefore recommend that the legislation implementing Professor Diamond's recommendations should specifically provide that mortgages of interests in mixed funds come within the personal property notice filing system and not within the land charges or land registration systems, whether or not the fund includes or consists of land. However, until mortgages of interests in mixed funds can be specifically excluded in this way, they cast

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<sup>40</sup> From the purchaser's point of view the danger is that any overreachable interest that may exist will not be overreached and will be binding on the purchaser as an overriding interest by virtue of Land Registration Act 1925, s. 70(1)(g) if the holder of the interest is in actual occupation of the land: *Williams & Glyn's Bank Ltd. v. Boland* [1981] A.C. 487. From the beneficiary's point of view the danger is that the beneficial interest will not be overreached (and therefore the beneficiary will be deprived of the safeguard—such as it is—of having the trust money paid to more than one trustee) but nor will it be binding on the purchaser, because for one reason or another it falls outside s. 70(1)(g).

<sup>41</sup> As far as a caution is concerned, see *Elias v. Mitchell* [1972] Ch. 652 and Land Registration Act 1925, s. 54(1). A notice may not be entered directly in respect of the interest under the trust itself, but can be lodged pending the appointment of trustees: Land Registration Act 1925, s. 49(2).

<sup>42</sup> [1988] 1 W.L.R. 940.

<sup>43</sup> Land Registration Act 1925, s. 59.

<sup>44</sup> (1989, H.M.S.O.).

<sup>45</sup> Because perfection and priority are achieved by the chargee filing notice in a public register of the intention to take security of a specified type over the property of the debtor: details of any security interest in fact created are not recordable.

<sup>46</sup> In both systems the critical date is date of protection on a public register rather than date of creation or date of notice to trustees (as in the rule in *Dearle v. Hall* (1828) 3 Russ. 1, which currently governs priority between encumbrances over trust equitable interests). Also, priority gained by protection on the register is not liable to be affected by equitable principles such as the doctrine of notice.

doubts over the advisability of requiring all mortgages of trust equitable interests to be protected under the Land Registration Acts 1925 to 1988.

3.29 These two factors, coupled with the fact that, pending implementation of the recommendations made in our Third Report on Land Registration, protection by caution (and probably by notice) has no priority effect,<sup>47</sup> lead us (reluctantly) to the conclusion that it would be premature to bring mortgages of trust equitable interests within the land registration system. Accordingly we recommend that protection and priority of trust equitable interests should continue to be governed by the rule in *Dearle v. Hall*<sup>48</sup> for the present. However, we hope that the necessary changes in the law will be made as quickly as possible so that all land mortgages can be brought within the land registration system.<sup>49</sup>

### **Protection and Priority in Unregistered Land**

3.30 In unregistered land the only method of registration available for land mortgages is registration as a land charge under the Land Charges Act 1972. In the present law the only consensually created mortgages and charges that are registrable are legal and equitable mortgages and charges of a legal estate (but only if the title deeds relating to the legal estate have not been deposited with the mortgagee) and mortgages and charges of commercial equitable interests.<sup>50</sup> Mortgages and charges that are not registrable as land charges are governed by the equitable priority rules explained in paragraphs 3.10 to 3.20 of the Working Paper, which we do not need to repeat here. In accordance with the principles explained in paragraph 3.18 above, we would like to see all formal and informal land mortgages registrable as land charges in unregistered land. In the following paragraphs we consider how far this is feasible.

#### *Formal and informal mortgages of a legal estate*

3.31 The obvious way of dealing with mortgages of a legal estate is to provide that formal land mortgages should be registrable as Class C(i) land charges,<sup>51</sup> and informal land mortgages as Class C(iii) land charges.<sup>52</sup> The only question that causes any difficulty is whether this should apply to all mortgages, as we suggested in the Working Paper,<sup>53</sup> or only to those not protected by deposit of title deeds. Response to the suggestions made in the Working Paper confirmed our view that this is essentially a practical problem. The relatively few disagreements with our proposals were not so much over whether as a matter of principle all mortgages ought to be registered (overwhelmingly there is agreement that they should) as over the amount of trouble it is worth taking to simplify unregistered conveyancing. We remain convinced that deposit of title deeds is a poor substitute for registration. No-one now devising a system for the protection and priority of mortgages would contemplate introducing a rule that mortgagees who want to hold the title deeds of the mortgaged property not only are not obliged, but are not *entitled* to take part in the registration system governing other mortgages and encumbrances over the same property. However, given that such a system exists, the issue is whether it should be allowed to continue until all titles have become registered at H.M. Land Registry, or whether it should be changed now. One reason for taking action now is that it would remove a significant impediment to simplification: as long as the rule remains that mortgages protected by deposit of title deeds are not registrable as land charges, there is little prospect of doing anything about the arcane complexities of the protection and priority rules described in

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<sup>47</sup> This is the problem we discuss in para. 3.21 above in relation to protection of informal land mortgages of a legal estate.

<sup>48</sup> (1828) 3 Russ. 1, as amended by Law of Property Act 1925, ss. 137–8. For what this entails, see Working Paper, paras. 3.18–3.20.

<sup>49</sup> The present policy is that some mortgageable interests (for example, short leases) will never be substantively registrable, but will continue to be overriding interests. This does not necessarily mean that their priority must continue to be governed by present unregistered land principles: once universal registration of title has been achieved (or possibly even before then) it may be decided to introduce in Land Registration legislation special priority rules for such interests, designed to harmonise with priority rules governing registered and protected interests.

<sup>50</sup> i.e. equitable interests such as agreements for lease, options to purchase and other estate contracts that arise by virtue of a contractual right to acquire a legal estate, as opposed to equitable interests arising under a trust: see further paras. 2.25 and 3.23 above.

<sup>51</sup> At present Class C(i) comprises puisne mortgages, defined in s. 2(4) of the Land Charges Act 1972 as legal mortgages “not protected by a deposit of documents relating to the legal estate affected”.

<sup>52</sup> In the present law, Class C(iii) comprises general equitable charges, which are defined in s. 2(4) of the 1972 Act. They include equitable charges, “not secured by a deposit of documents relating to the legal estate affected”, and not arising or affecting an interest arising under a trust for sale or settlement.

<sup>53</sup> Paras. 5.7 and 5.9.

paragraphs 3.10 to 3.17 of the Working Paper. Consultation confirmed our impression that the problems explained in those paragraphs cause no great difficulties in practice. Nevertheless, it seems likely that unregistered land principles will continue to apply to significant numbers of mortgages for many years,<sup>54</sup> and it would be unfortunate if such uncertainties and complexities had to be perpetuated on such a scale over such a long period.

3.32 It seems clear from the responses to the Working Paper of those who have to deal with large numbers of mortgages (notably the Land Registry, but also many institutional lenders) that the registration of all existing mortgages currently protected by deposit of title deeds would be a formidable task, and that the costs involved would be disproportionate to the benefits that would be achieved. However, the same objections do not apply to new mortgages, and we conclude that the benefits of extending registration to them outweigh the costs of doing so. We therefore recommend that all formal land mortgages of a legal estate should be registrable as Class C(i) land charges, and all informal land mortgages of a legal estate should be registrable as Class C(iii) land charges.

#### *Formal and informal mortgages of equitable interests*

3.33 The problems here are much the same as in registered land, and the same considerations apply. In other words, ideally we would prefer all mortgages of equitable interests to be registrable as land charges, but for the reasons explained in paragraphs 3.22 to 3.29 above we consider that this is not feasible in the case of mortgages of trust equitable interests. Accordingly we recommend that a formal land mortgage of a commercial equitable interest<sup>55</sup> should be registrable as a Class C(i) land charge, and that an informal land mortgage of a commercial equitable interest should be registrable as a Class C(iii) land charge, but that formal and informal mortgages of trust equitable interests<sup>56</sup> should continue to be governed by the rule in *Dearle v. Hall*.<sup>57</sup>

#### *Other amendments to the Land Charges Act 1972*

3.34 In the Working Paper we suggested that if amendments were to be made to the Land Charges Act 1972 the opportunity should be taken to amend section 4(5) of the Act so as to avoid the problems of circular priority we explained in paragraph 3.12 of the Working Paper. The problem is essentially that because of defective drafting of section 4(5), insoluble priority circles can arise where there are successive registrable mortgages of the same property, and a later one is created before an earlier one is registered. Section 4(5) provides that a Class B and Class C land charge<sup>58</sup> is void against a purchaser unless registered "before the completion of the purchase". The problems are solved if, in cases where the "purchase" in question is the creation of a mortgage or similar interest, "before completion of the purchase" is replaced by "before registration of that mortgage etc as a land charge." We recommend that the appropriate amendment should be made to section 4 to achieve this.

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<sup>54</sup> The process of extending compulsory registration to the whole of England and Wales was completed on 1 December 1990: Registration of Title Order 1989, S.I. 1989, No. 1347. The next step in the progression towards universal registration will be to increase the range of circumstances triggering compulsory first registration of title within areas of compulsory registration. It would be a welcome simplification of the mortgage system (both in its present state, and under the new scheme we recommend) if all mortgages were governed by registered land principles. A way of achieving this that we would favour would be to make the grant of a mortgage (a legal mortgage in the present law, and a formal land mortgage when the new scheme is implemented) of an unregistered but registrable interest an occasion demanding first registration of the mortgagor's title.

<sup>55</sup> i.e. an equitable interest such as an agreement for lease, option to purchase, or other estate contract that arises by virtue of a contractual right to acquire a legal estate: see further paras. 2.25 and 3.23 above.

<sup>56</sup> i.e. interests of beneficiaries under a trust of land.

<sup>57</sup> (1828) 3 Russ. 1, as amended by Law of Property Act 1925, ss. 137–8. The way in which this operates, and the unsatisfactory features of the rule, are explained in paras. 3.18–3.20 of the Working Paper.

<sup>58</sup> Other than an estate contract.

**Summary of the new mortgage structure**

3.35 The effect of our recommendations is summarised in the following table:

Type of mortgage	Method of creation	Nature of Mortgaged Property	Protection and Priority	
			Registered Land	Unregistered Land
Formal land mortgage	Deed	Legal Estate	Registration	Registration as C(i) land charge
		Commercial Equitable Interest (1)	Notice or Caution	Registration as C(i) land charge
		Trust Equitable Interest (1)	Not protectable on Register: notice to trustees under rule in <i>Dearle v. Hall</i> (2)	Not registrable: notice to trustees under rule in <i>Dearle v. Hall</i> (2)
Informal land mortgage	Deed or signed writing satisfying the requirements of s. 2 Law of Property (Miscellaneous Provisions) Act 1989	Legal Estate	Notice or Caution	Registration as C(iii) land charge
		Commercial Equitable Interest (1)	Notice or Caution	Registration as C(iii) land charge
		Trust Equitable Interest (1)	Not protectable on Register: notice to trustees under rule in <i>Dearle v. Hall</i> (2)	Not registrable: notice to trustees under rule in <i>Dearle v. Hall</i> (2)

(1) Paras. 2.25 and 3.24 above.

(2) Para. 3.29 above.

## PART IV

### PROTECTED MORTGAGES

#### The need for a protected class of mortgage

4.1 Parts V and VI of this Report deal in detail with the form of formal land mortgages (in particular, the extent to which form and content can and should be standardised) and with the rights and duties of the parties to a formal land mortgage during the security. As soon as one starts to consider such matters it becomes apparent that different types of mortgage have very different requirements. The most important differences lie in the extent to which the law needs to interfere with the parties' freedom of contract. If all provisions have to apply equally to all types of mortgage, it is difficult to reconcile the need to allow maximum flexibility to commercial transactions entered into between parties of equal bargaining power, with the need to provide adequate protection for vulnerable mortgagors who in a wholly free market would have no real choice but to accept whatever terms lenders may choose to dictate. The obvious way of reconciling these conflicting needs is to have a protected class of mortgage, and to confine to that class some of the mortgagor protection provisions that might not be thought necessary or desirable for all mortgages.

4.2 The idea of having a protected class of mortgage is not a novel one in mortgage law in this country. In the present law there are at least three differently defined classes of mortgage affected by different statutory mortgagor protection provisions.<sup>1</sup> There are obvious attractions in simplifying this structure by combining these different classes to form a single protected class of mortgage.

4.3 Responses to the Working Paper confirmed that there is broad acceptance of the value of having a protected class of mortgage. There is less agreement about the contents of such a class. The major difference of opinion is between those who want the class to be defined by reference to the purpose of the loan, and those who would define it by reference to the use of the property mortgaged. We see a number of disadvantages in the former approach. First, there is no satisfactory method of ensuring that a mortgagor uses the loan for the stated purpose. In practice, lenders would have to be entitled to assume that the mortgagor would use the loan for the purpose for which it was requested: it was strongly argued to us that this would offer unscrupulous lenders too easy a means of avoiding protection. Secondly, there was no clear agreement amongst those who responded on this point as to which purposes should be protected and which not. Those who lend primarily on second mortgages advocated protection only for house purchase mortgages; those who lend mainly for house purchase and home improvement purposes advocated protection only for mortgages of dwelling houses securing loans for business purposes or consumer debts; those who lend for business purposes advocated protection only for mortgages securing consumer debts. Thirdly, each purpose which someone proposed should be excluded from protection, was put forward by someone else as a case in particular need of protection. On the whole, we found the arguments for protection more convincing than the arguments against.

4.4 What did become clear was that in considering the need for a protected class, none of our respondents contemplated protection for mortgages of non-residential premises, whatever the purposes of the loan: the disagreement was essentially over which mortgages of residential premises should be protected. For this reason, and the reasons given in the previous paragraph, we prefer the view of those who argued that the protected class ought to be defined by reference to the nature of the mortgaged property rather than the purpose of the loan, and that essentially the protected class ought to consist of all residential mortgages.

4.5 In considering how far to refine the idea of residential mortgages as a protected class,

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<sup>1</sup> Administration of Justice Act 1970, s. 36 (as amended) gives the court a certain degree of control over the enforcement of mortgages of dwelling-houses (regardless of who the mortgagor is): see Working Paper, para. 3.69; the Consumer Credit Act 1974 imposes an extensive protection code, covering advertisements, form and content of documents, and enforcement of the security, in relation to the (relatively few) "regulated" mortgages to which it applies (as to which see Working Paper, paras. 3.40-3.43, 3.68 and 5.45); and the Consumer Credit Act 1974, ss. 137-140 gives the court jurisdiction to re-open extortionate credit bargains, applicable to all mortgages (not just of dwelling houses) where the mortgagor is an individual (see Working Paper, 3.38).

we have been guided by two principles. The first (which was strongly urged on us by most of those who responded to the Working Paper) is the need to keep the definition simple: for lenders in particular certainty of definition is of paramount practical importance. The second is that the underlying reason for regarding residential mortgagors as especially vulnerable is that they have put the homes of themselves and their families at risk by entering into the mortgage. Given that this is so, there is no need for the protected class to include cases where the mortgagor is a commercial organisation, such as a body corporate, or cases where enforcement of the mortgage would not affect the occupation of those living in the dwelling-house (for example, because the mortgagors are landlords mortgaging their reversionary interests, or where for some other reason the interests of the occupiers in the dwelling-house are binding on the mortgagee). On the other hand, if the key factor is the mortgagor's home being put at risk, it would require compelling arguments to justify excluding any other mortgage of a dwelling house from the protected class. No such arguments were put forward.

4.6 Accordingly we recommend that there should be a class of protected mortgage, and that protected mortgages should consist of all formal and informal land mortgages of any interest in land which includes a dwelling-house except those where either (a) the mortgagor is a body corporate,<sup>2</sup> or (b) enforcement of the mortgage would not affect the occupation of the dwelling-house or (c) the dwelling-house is occupied under a service tenancy.<sup>3</sup>

#### **Agricultural land**

4.7 It will be apparent from the preceding paragraph that we are not recommending special treatment for mortgages of agricultural land. The Agricultural Mortgage Corporation, and others concerned with secured lending to farmers, pointed out that most agricultural mortgages would fall within the definition of protected mortgage, since it is usual (and, apparently, desirable from the mortgagee's point of view) to mortgage the farmhouse with the farm. They also argued that this is not appropriate, since agricultural mortgages are primarily commercial mortgages. However, since the arguments they put to us were not essentially different from those that could be put in relation to any mortgage of mixed business and residential premises, we do not think that a case has been made out for treating agricultural mortgages differently from other mortgages of mixed business and residential premises. We deal with these mortgages in the following paragraph.

#### **Mixed business and residential premises**

4.8 Some<sup>4</sup> mortgages of property which is used partly for residential purposes but partly (even mainly) for other purposes will be included within the protected class. We do not consider it would be right to refine the definition of protected mortgage to exclude these mortgages: if as the result of enforcement of the mortgage an occupier of a dwelling house is evicted, then in principle the mortgage ought to be protected. However, we recognise that mortgagees of mixed premises may require wider powers than those appropriate for mortgagees of purely residential premises. We recommend below that these mortgagees should have powers to take possession, appoint a receiver, and grant leases of the non-residential part of the property (and, in exceptional circumstances, of the dwelling-house as well) in circumstances in which these powers would not be available to other protected mortgagees.<sup>5</sup> Also, since the mortgage loan is likely to be financing the business carried on

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<sup>2</sup> Although this is a somewhat crude way of distinguishing commercial mortgagors from private residential mortgagors (in that it does not exclude mortgagors who are partnerships, unincorporated bodies, or trustees) it has the advantage of simplicity. It is essentially the same solution as that adopted for the extortionate credit bargain provisions in ss. 137-140 of the Consumer Credit Act 1974 (ss. 137-140 apply to mortgages by an individual, which by s. 189 "includes a partnership or other unincorporated body of persons not consisting entirely of bodies corporate"). Most mortgages by partnerships, unincorporated bodies and trustees which are essentially commercial will anyway be excluded from protection by paragraph (b) (enforcement of the mortgage would not affect the occupation of the dwelling-house).

<sup>3</sup> The object of this last exclusion is to exclude cases where commercial premises include a caretaker's flat occupied by an employee for the purposes of the business, who would not normally expect to continue to occupy the flat after the business ceased to be carried out at the premises as a result of enforcement of the mortgage.

<sup>4</sup> i.e. those not excluded from the protected class by exclusions (a), (b) or (c) in para. 4.6, above. This means that mortgages of mixed premises will not be protected if the mortgagor is a body corporate, or the occupier of the dwelling-house has an interest in the dwelling-house which is binding on the mortgagee, or is a service tenant.

<sup>5</sup> See paras. 7.36, 7.42 and 7.47 below.

in the non-residential part of the premises, we recommend that provisions postponing redemption should be treated in the same way as in non-protected mortgages, and not subject to the absolute prohibition we recommend for other protected mortgages.<sup>6</sup> With these modifications to the protection provisions, we do not anticipate that it will cause significant problems to include mortgages of mixed residential and non-residential premises within the protected class, whether the non-residential part is used for agricultural or other business purposes. Such mortgages have always been subject to the restrictions on enforcement imposed by section 36 of the Administration of Justice Act 1970. As far as we know this has not caused problems, no doubt at least partly because protection can readily be avoided (as can the protection we recommend here) by the mortgagee either taking separate mortgages of the residential and the commercial parts of the premises, or insisting on the mortgage being granted by a company rather than by an individual.

#### **Consumer Credit Act 1974**

4.9 A further point that should be noted is that the definition of protected mortgage we recommend includes virtually all mortgages presently covered by the Consumer Credit Act 1974.<sup>7</sup> Responses to the Working Paper confirmed our preliminary view that in the interests of simplification of the law, protection under the new land mortgages legislation should replace protection under the Consumer Credit Act 1974 as far as land mortgages are concerned. We return to this point in Part IX of the Report.

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<sup>6</sup> See paras. 6.42–6.43 below.

<sup>7</sup> In theory, there could be mortgages of non-residential land which come within the definition of mortgages securing regulated agreements for the purposes of the Consumer Credit Act 1974 but do not fall within our definition of protected mortgage. The result of our recommendations will be that such mortgages will lose their Consumer Credit Act protection. Although we asked for information about such mortgages in the Working Paper, we received no evidence that such mortgages occur in practice, or that it would cause any problems if they were excluded from all protection.

## PART V

### FORM OF FORMAL LAND MORTGAGE

#### Standardisation

5.1 In the Working Paper we considered under the heading of standardisation of mortgages three separate but connected issues:

- (a) whether a Land Mortgages Act should provide one or more standard forms of mortgage, and if so, whether their use should be mandatory in all cases, or in some cases, or in none;
- (b) whether the Act should contain standard mortgage terms, and if it did, first, whether they should be overriding<sup>1</sup> or variable by the parties, and secondly whether the parties should be required to reproduce the statutory mortgage terms (as varied) in the mortgage deed;
- (c) whether the Act should prescribe information to be contained in some or all mortgages.

#### Standard forms

5.2 The point here is essentially uniformity of *format* rather than uniformity of *content*. There was considerable support for the view expressed in the Working Paper that there are significant benefits to be obtained by ensuring that, so far as possible, the principal terms of a mortgage are presented in a uniform style in a uniform layout. It facilitates the mechanisation (whether by computerisation or otherwise) of conveyancing processes, which is of benefit to institutional lenders, to conveyancers, and to those responsible for registration. It can also have a mortgagor protection function by ensuring that prominence is given to significant terms. It involves producing one or more short standard mortgage forms (on the lines of the one suggested in paragraph 5.32 of the Working Paper) of universal application to all different types of transaction. The standard form could comprise the mortgage deed itself, and into it there would then have to be incorporated by reference the other documents setting out the detailed provisions governing that particular transaction. Alternatively, the standard form might comprise the standard front page of all mortgages, the succeeding pages containing the provisions special to the particular transaction. It was generally agreed by those who commented on these provisions of the Working Paper that a short standard form applicable to all mortgages could be devised, and the form described in paragraph 5.32 of the Working Paper was generally considered adequate for these purposes. The form in the Working Paper contained:

- (a) the date of the mortgage;
- (b) the names and addresses of the parties to the mortgage;
- (c) the description of the mortgaged property (including Title Number if title registered at H.M. Land Registry) and the nature of the interest mortgaged;
- (d) a charging clause, in very general terms (for example, "The mortgagor [as beneficial owner]<sup>2</sup> mortgages the property as security for the payment and discharge of all money and liabilities due for the time being from the mortgagor to the mortgagee under the terms of this mortgage");
- (e) any further information necessary to comply with registration requirements, such as whether the mortgage is a continuing security and secures further advances; and
- (f) (if the standard form comprises the mortgage itself, rather than the front page of it) details of collateral documents intended to be incorporated into the mortgage.

The Building Societies Association has already adopted a similar form, and we believe it is widely used. However, whilst it was generally agreed that the adoption of such a form could make residential conveyancing cheaper and quicker, there was less support for achieving this by the means of a statutorily prescribed form the use of which would be made compulsory. It was argued that statutory standard forms are inflexible, and that even

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<sup>1</sup> i.e. the parties should not be free to vary them: see para. 3.3 above.

<sup>2</sup> In relation to implied covenants for title, see our proposals for amending the content of the covenants and the key words to introduce them: Transfer of Land—Implied Covenants for Title, (1991) Law Com. No. 199.



the simplest form can become inappropriate to current conditions after only a few years.<sup>3</sup> Whilst we acknowledge the force of this argument, we think the problems of inflexibility can be largely removed by having the forms prescribed by statutory instrument rather than by statute, especially if the forms can be settled by a body responsible for monitoring their effectiveness in consultation with lenders and consumer organisations. This is a function that the Office of Fair Trading already fulfils in relation to mortgages securing regulated agreements under the Consumer Credit Act 1974, and would be well suited to fulfil in relation to protected mortgages.

5.3 As far as protected mortgages are concerned, we consider that the advantages of prescribed standard forms outweigh the disadvantages, particularly when viewed in conjunction with the advantages to be gained from the use of standard mortgage terms, which we consider below. Accordingly we recommend that standard form(s) on the lines described in the preceding paragraph should be prescribed by regulation, to be settled by the Office of Fair Trading which would be responsible for consulting lenders and consumers' organisations, and for monitoring the suitability of the form(s).

5.4 In commercial cases standard forms do not have the same advantages. Most<sup>4</sup> protected mortgages are granted and discharged in the course of routine residential conveyancing, and it is primarily in residential conveyancing, where large numbers of similar transactions have to be dealt with by several different people,<sup>5</sup> that it is worth insisting that the same information is dealt with in the same way in the same place in each document. In the case of commercial mortgages there is less uniformity. The circumstances in which commercial mortgages are granted are more various, and the financial terms are more likely to vary from transaction to transaction. Also, there is less need to ensure that, for mortgagor protection purposes, significant terms are given due prominence in the documentation. For these reasons we recommend that no standard form mortgages should be prescribed for use outside the sphere of protected mortgages.

### Standard Terms

5.5 The question of standardising the *content* of mortgages by producing standard terms or conditions raises rather different issues. In this context, statutory mortgage conditions can fulfil three different functions. The first is that, by setting out the *prima facie* rights and duties of the parties, they define the nature of the relationship created by the new mortgage. To the extent that standard terms are fulfilling this function they should be largely overriding (that is, not variable by the parties), to ensure that the essential nature of the transaction is preserved.<sup>6</sup> While the parties would not be able to vary overriding provisions, either in the mortgage document or by any other oral or written agreement at that time or later, it will be seen that they are not all inflexible. For example, the mortgagee's duty to repair the property while in possession would be the equivalent of whatever obligation was imposed on the mortgagor during his period of possession of the property, and the mortgagor's statutory repairing duty would be capable of variation or total exclusion in accordance with the parties' wishes.<sup>7</sup> Again, the freedom which the mortgagor would have to grant leases while he was in possession would be modified by the

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<sup>3</sup> The fate of prescribed form ship mortgages is instructive. Two alternative standard forms were set out as Form B in Sched. 1, Pt. 1 to the Merchant Shipping Act 1894, and a mortgage of a ship or share was not registrable unless in the prescribed form "or as near thereto as circumstances permit" (s. 31 *ibid.*). The first of the two forms became obsolete because the provisions for repayment were too specific. The second form (to secure an "account current") did not comply with the requirements of the International Convention on Maritime Liens and Mortgages 1967, governing the recognition and priority of foreign mortgages in other jurisdictions, because the form did not require the maximum amount secured to be specified (Article 1 of the Convention). The prescribed forms were repealed by the Merchant Shipping Act 1988 Sched. 1, para. 20: Commissioners of Customs and Excise now produce non-prescribed standard forms.

<sup>4</sup> Not all: mortgages of dwelling houses to secure consumer or business debts are an important part of the residential mortgage market. For the particular problems arising in relation to such mortgages, see the National Consumer Council, *Security Risks: Personal Loans Secured On Homes* (1987) and *Credit and Debt—The Consumer Interest* (1990, H.M.S.O.).

<sup>5</sup> For example, drawing up, executing and registering a house purchase mortgage deed is likely to require the involvement of the purchasers themselves, their legal advisers, staff at the local office of the mortgagee, and/or their legal advisers, and Land Registry staff. The deed may also have to be scrutinised by staff at an insurance company's office.

<sup>6</sup> See para. 3.3 above. We also propose the use of an overriding provision to implement our recommendation that the right of consolidation be abolished (para. 6.44 below). This enables the new legislation to follow the format of s. 93(1) of the Law of Property Act 1925, thereby emphasising the nature and extent of the reform.

<sup>7</sup> Para. 6.13 below.

fact that no lease would bind the mortgagee or a receiver unless the mortgagee had given his written consent to it; the mortgagee would therefore have a complete discretion in deciding whether to be bound by leases created by the mortgagor.<sup>8</sup>

5.6 The second function of standard terms is to provide minimum rights and protection for protected mortgagors. To the extent that standard terms have this mortgagor protection function, they should be overriding in protected mortgages but largely variable in non-protected mortgages. The third function is to produce simple, uniform, and modern formulations of provisions commonly found in all mortgages. The objective in drafting such conditions is to produce a formulation acceptable to most mortgagors and mortgagees in most circumstances, so that the parties would not usually choose to vary the standard conditions (whilst they remain free to do so). Some conditions may of course fulfil more than one of these functions.

5.7 Amongst those who responded to the Working Paper, there was considerable support for the view that it is necessary and desirable to have standard mortgage terms fulfilling these functions to at least some extent. There was, perhaps inevitably, less agreement over precisely what the terms should be and the extent to which they should be variable. Nevertheless, the level of agreement was sufficient to enable us to formulate terms that we consider would be generally acceptable. These are set out and explained in Parts VI and VII of the Report.

5.8 It may nevertheless be useful for us to summarise here those terms which we propose should be overriding in the case of all mortgages, whether or not protected:

- (a) An obligation to keep the title deeds safe and to afford the mortgagee facilities to inspect and make copies of them.<sup>9</sup>
- (b) The mortgagor to have the right to possession of the premises<sup>10</sup> unless, where the mortgage is a formal land mortgage, the mortgagee takes possession either to sell the property,<sup>11</sup> in which case the sale is to take place promptly<sup>12</sup> and in the meantime the mortgagee is to be liable to account for income received or which ought to have been received,<sup>13</sup> or to prevent or reverse a fall in the value of the property, in which case the mortgagee is only to retain possession for so long as is reasonable for that purpose.<sup>14</sup>
- (c) While in possession, the mortgagee is to have obligations to repair and to comply with obligations affecting the property which correspond to the duties of the mortgagor while in possession.<sup>15</sup>
- (d) The mortgagee's power of sale is only to be exercised if the mortgagor is in arrear with a payment, there is an outstanding breach of covenant substantially prejudicing the mortgagee's security or an event has occurred which substantially reduces the mortgagor's ability to meet his financial obligations or which prejudices the value of the property as security.<sup>16</sup> In the case of bankruptcy, the power is only to be exercised with leave of the court. A sale by a receiver is to be subjected to similar constraints.<sup>17</sup>
- (e) The mortgagor is to have an unfettered right, while in possession, to grant leases, but only a lease granted with the mortgagee's consent will bind the mortgagee or a receiver.<sup>18</sup> The mortgagee in possession or a receiver will have an unfettered right to grant leases for the purposes of a sale or to protect the security, or with the mortgagor's consent.<sup>19</sup>
- (f) Money in the hands of a receiver is to be paid out in accordance with the established order of priority.<sup>20</sup>

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<sup>8</sup> Para. 6.19 below.

<sup>9</sup> Para. 6.8 below.

<sup>10</sup> Para. 6.16 below.

<sup>11</sup> Para. 7.29 below.

<sup>12</sup> Para. 7.30 below.

<sup>13</sup> Paras. 7.37–7.38 below.

<sup>14</sup> Para. 7.36 below.

<sup>15</sup> Para. 6.15(e) below.

<sup>16</sup> Para. 7.8 below.

<sup>17</sup> Para. 7.43 below.

<sup>18</sup> Para. 6.19 below.

<sup>19</sup> Para. 7.47 below.

<sup>20</sup> Para. 7.44 below.

(g) There is to be no right of consolidation.<sup>21</sup>

### Prescribed information

5.9 It was strongly urged by consumers' organisations and those involved with advising mortgagors that prospective mortgagors ought to be provided with a clear explanation of the consequences of entering into a mortgage. We agree that this is essential for all mortgagors, and we hope that the implementation of the recommendations we make in this Report for simplifying and clarifying the law will facilitate this. In the case of non-protected mortgages we consider that, once the law has been made more rational and comprehensible, it can then be left to the mortgagor's legal adviser to ensure that the mortgagor is made aware of the consequences of granting a mortgage. In the case of protected mortgages, however, we agree with those who argue that something more is required. One of the ways of dealing with this that we recommend is to adopt for all protected mortgages a system similar to that already in operation in relation to mortgages securing regulated agreements under the Consumer Credit Act 1974. Statutory instruments made under the Consumer Credit Act 1974 regulate the wording of advertisements offering secured loans<sup>22</sup> and the form and content of mortgage deeds and related documents, and require copies of mortgage documents to be provided for everyone concerned at all significant stages of the transaction.<sup>23</sup> Some lenders and legal advisers have criticised the complexity of these Consumer Credit Act Regulations, and what they have seen as the unnecessary proliferation of copy documents to be supplied. However, the Office of Fair Trading has kept the content of the regulations under constant review, and extensive changes in detail have been made in response to criticisms, after consultation with lenders and consumer organisations. We believe that a similar system applicable to all protected mortgages would work well, and it would actually be simpler than the present system in that one of the major complexities in the present law is trying to ascertain which mortgages are currently excluded from the Consumer Credit Act Regulations.<sup>24</sup> The new system applicable to all protected mortgages would then replace the Consumer Credit Act system as far as it relates to land mortgages.

5.10 We recommend that the precise content of the mortgagor protection information to be prescribed by regulation<sup>25</sup> should be settled after consultation with lenders and consumer organisations by the Office of Fair Trading, which should be charged with the responsibility of monitoring the effectiveness and efficiency of the regulations. We would expect prescribed information for inclusion in mortgage deeds to include clear and prominent explanations of the effect of financial provisions (in particular, those making the mortgage secure all monies owing to the lender, and those making the loan repayable on demand), the circumstances in which the mortgagee would be entitled to enforce the security, the form enforcement might take, the procedure to be followed on enforcement, and the consequences to the mortgagor of successful enforcement.

5.11 We said in the previous paragraph that this was only one of the methods we recommend should be adopted for ensuring that protected mortgagors are fully informed. The other involves returning to the question of the format of the mortgage document(s). It will be apparent from the preceding paragraphs that we recommend that a protected mortgage should contain the following elements: the short standard form we recommend in paragraph 5.2 above; standard mortgage conditions, some of which will be varied by terms expressly agreed between the parties; other express terms; and whatever information

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<sup>21</sup> Para. 6.44 below.

<sup>22</sup> Consumer Credit (Advertisements) Regulations 1989, S.I. 1989, No. 1125. In *R. v. Secretary of State for Trade and Industry, ex parte First National Bank plc*. *The Times* 7 March 1990 the Court of Appeal held that the requirement imposed by the 1989 Regulations that advertisements for loans secured on dwelling houses should include a warning in prescribed form of the risks of mortgaging one's home was not *ultra vires* or unreasonable.

<sup>23</sup> Consumer Credit (Agreements) Regulations 1983, S.I. 1983, No. 1553 and Consumer Credit (Cancellation Notices and Copies of Documents) Regulations 1983, S.I. 1983, No. 1557, both frequently amended, most recently by S.I. 1988, No. 2047 and S.I. 1989, No. 591.

<sup>24</sup> Most of those who responded to the Working Paper endorsed our view of this as a major criticism of the application of the Consumer Credit Act 1974 to land mortgages: see para. 3.41 of the Working Paper. The "mass of subordinate legislation" listed in n. 126 to that paragraph has since been amended on at least eight subsequent occasions (S.I. 1986, Nos. 1105 and 2186; S.I. 1987, No. 1578; S.I. 1988, Nos. 707 and 991; S.I. 1989, Nos. 869, 1841 and 2337).

<sup>25</sup> This also applies to the content of regulations concerning provision of copies, but not those regulating advertisements. As we explain in para. 9.6 below, we recommend that the provisions of the Consumer Credit Act 1974 relating to the carrying on of mortgage lending business should remain applicable to land mortgages.

is required by the regulations we recommend in paragraphs 5.9 and 5.10 above. The question remains whether all of these ought to be set out in a single document. If the sole objective of standardisation is to make the creation and discharge of mortgages quicker, more efficient, and hence cheaper, the best solution is probably to have a short form standard mortgage deed, with the statutory standard conditions automatically implied into it, and with all their express terms and statutory mortgagor protection information set out in ancillary documents incorporated into the mortgage by reference.<sup>26</sup> It was confirmed by lending institutions and their advisers and those responsible for registration that they would find such a system much easier and cheaper to operate.<sup>27</sup> However, it suffers from the major disadvantage of making it more rather than less difficult for the mortgagor to find out and understand the terms of the mortgage. This is especially likely to cause problems on occasions when the mortgagor is unlikely to have the benefit of legal advice. For example, a mortgagor who needed to find out about continuing obligations such as repair or insurance, or the likely consequences of any default, would have to find the relevant Act of Parliament containing the statutory standard conditions, and then try to work out what it meant when read together with possibly overlapping and conflicting provisions contained in a printed booklet incorporated into the mortgage by reference. In practice these problems may well be compounded by difficulties in locating a copy of the correct version of documents intended to be incorporated by reference but since mislaid. On balance we consider that this outweighs the advantages of the simpler and cheaper system. Accordingly we recommend that, in the case of protected mortgages, the mortgage deed must contain a comprehensive statement of all the mortgage terms, in that:

- (a) the statutory standard form we recommend in paragraph 5.2 above should form the front page of all protected mortgages (with the addition of such wording as may be prescribed by regulations made under the powers we recommend in paragraphs 5.9 and 5.10 above); and
- (b) the statutory mortgage conditions, as varied by any express terms of the mortgage, should be set out in full in the mortgage deed.

The same considerations do not apply with the same force to non-protected mortgages, and accordingly we recommend that the parties should be free to set out the statutory conditions or not, as they prefer.

#### **Effect of failure to comply with standardisation requirements**

5.12 As we explained in paragraphs 3.6 and 3.10 above, it was strongly urged by consumers' associations that, in the case of protected mortgages, a formal land mortgage that failed to comply with any of the requirements recommended in this Part of the Report should be void. We explained there why we reject that suggestion and recommend instead that failure to comply should affect enforcement of the security and/or cause the mortgagee to be penalised in costs: it should not affect the nature or validity of the mortgage. More particularly we recommend:

- (a) on an application by a mortgagee to perfect a protected informal land mortgage<sup>28</sup> or to enforce a protected formal land mortgage,<sup>29</sup> if there has been a failure to comply with standardisation requirements then the court should have a discretion to refuse to make the appropriate order, or to make it subject to whatever conditions the court thinks fit;
- (b) the court's discretion should extend to allowing it to do whatever it considers just in the circumstances, so that it should be open to the court either to disregard the mortgagee's failure or to penalise the mortgagee for it in any way the court thinks fit;
- (c) subject to (b), if the failure is in the provision of prescribed information or copies of documents<sup>30</sup> there should be a burden on the mortgagee to satisfy the court that at the creation of the mortgage, the mortgagor received as full an explanation of

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<sup>26</sup> Compare the solution adopted in Scotland, where a new standard security was introduced by the Conveyancing and Feudal Reform (Scotland) Act 1970, Pt. II, implementing the recommendations of the Halliday Committee on Conveyancing Legislation and Practice made in their 1966 Report (Cmnd. 3118). The Act prescribes standard forms and standard conditions: see further, Working Paper, para. 5.44.

<sup>27</sup> The Land Registry has recently changed its procedure for dealing with the registration of charges incorporating other documents by reference: rule 139 of the Land Registration Rules 1925, S.R. & O. 1925 No. 1093, added by the Land Registration (Charges) Rules 1990, S.I. 1990, No. 2613.

<sup>28</sup> Para. 3.11 above.

<sup>29</sup> Para. 7.53 below.

<sup>30</sup> Paras. 5.9–5.10 above.

the consequences of the mortgage as if the statutory requirements regulations had been observed; notwithstanding (b) above, if the mortgagee is not able to satisfy the court of this, the failure should only be disregarded if the circumstances are exceptional; and

- (d) it should be within the court's discretion to penalise the mortgagee in costs in any way it thinks appropriate, and in particular by ordering the recovery of any costs of the mortgagee incurred at the time the mortgage was created which were paid by the mortgagor.

We also consider that the Chief Land Registrar ought to have discretion to refuse to register a protected mortgage without a standard front page,<sup>31</sup> but this is probably best dealt with either by subordinate legislation made under the Land Registration Acts 1925 to 1988, or by direct amendment to the Land Registration Acts.

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<sup>31</sup> i.e. as recommended in para. 5.11 above.

## PART VI

### RIGHTS AND DUTIES OF THE PARTIES DURING THE SECURITY

#### Introduction

6.1 For the reason we explained in Parts III and V of this Report we recommend that the legislation creating the new formal land mortgage should set out standard mortgage provisions to be implied into all mortgages. These provisions can be divided into two general categories. The first consists of provisions relating to the relationship of the parties during the security. The second consists of those relating to enforcement of the security. In this Part of the Report we deal with the first category of standard provisions, and also with other matters relating to the relationship of the parties during the security, namely transfer of the mortgage and of the mortgagor's interest in the mortgaged property, interest rates, and redemption and discharge of the security. In Part VII of the Report we deal with the standard mortgage provisions that relate to enforcement of the security, and also with other matters relevant to enforcement.

6.2 In deciding what elements of the mortgage relationship should be the subject of standard mortgage provisions, we have been guided by what we described in paragraphs 5.5 to 5.6 above as the three functions of standard conditions, that is: to define the nature of the relationship created by the new mortgage, to provide minimum rights and protection for mortgagors, and to provide a uniform and generally acceptable formulation of commonly occurring mortgage terms. As far as the last function is concerned, we sought to discover which mortgage terms could be reduced to a commonly acceptable uniform formulation by analysing the standard mortgage deeds used by thirty major lending institutions.<sup>1</sup> In the Working Paper we set out the conclusions we reached as a result of this analysis,<sup>2</sup> and most of those who responded to the Working Paper confirmed that they considered them generally acceptable. The recommendations we now make are based on the conclusions we reached as a result of that analysis of standard forms, modified to take into account the many valuable comments we received.

6.3 With this (and the other two functions of standard provisions) in mind, we recommend that, as far as rights and duties during the security are concerned, there should be standard provisions dealing with the following matters:

- (a) possession of documents of title;
- (b) insurance;
- (c) repair;
- (d) possession;
- (e) the grant of leases and derivative interests.

Our detailed recommendations about these provisions are set out in the succeeding paragraphs.

#### Standard Provisions

##### *Documents of title*

6.4 In the present law a first legal mortgagee has a statutory right to possession of the documents relating to the mortgagor's title to the mortgaged property. There are historical reasons for this. Before 1925 the mortgagee took an assignment of the mortgagor's interest, and hence, logically, also took custody of the title deeds relating to it. The policy of the 1925 property legislation was to put mortgagees with a mortgage by demise or charge by way of legal mortgage in no worse a position than they would have been in if they had taken a mortgage by assignment. In accordance with this policy it was expressly stated in the Law of Property Act 1925 that a mortgagee with a mortgage by demise (or, by implication, a charge by way of legal mortgage) should have the same right to possession of documents as if the security had been effected by assignment.<sup>3</sup> In the present law mortgagees take possession of the mortgagor's title deeds for a number of reasons. The first is that it provides a considerable degree of *de facto* protection against unauthorised dealings by the

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<sup>1</sup> For further details, see para. 5.36 of the Working Paper.

<sup>2</sup> At paras. 5.36–5.44.

<sup>3</sup> Law of Property Act 1925, ss. 85(1) and 86(1).

mortgagor: in unregistered and in registered land, there are few transactions relating to the mortgaged property that a mortgagor can complete without having to produce the title deeds or land certificate.<sup>4</sup> Secondly, it makes it easier to realise the security should the need arise.<sup>5</sup> Thirdly, it obviates the need to register the mortgage as a land charge in unregistered land.

6.5 It is not immediately obvious why mortgagees should be given the same right in the new system we recommend. Since we recommend that the protection and priority of mortgages of legal estates should be governed wholly by registration, there remains no role for possession of title deeds as a means of legal or *de facto* protection. Also, whilst we appreciate that lack of title deeds may well hinder realisations by mortgagees, possession of title deeds by mortgagees may equally hinder legitimate sales by mortgagors. Finally, there is the question of storage. Whilst it is relatively easy for mortgagors to arrange safe custody of their title deeds, it is extremely expensive for large institutional lenders to do so: in their evidence to the Government Conveyancing Committee the Halifax Building Society put forward storage of title documents as a significant problem.<sup>6</sup>

6.6 Nevertheless, it was clear from the responses we received to the Working Paper that mortgagees want to continue to hold the mortgagor's documents of title, and that if they do not have a statutory right to do so it will become the invariable practice to include a contractual right in each mortgage deed. So, even if not given a statutory right to the title deeds, they will take a contractual right unless this is positively prohibited by the legislation. We do not consider that the arguments against mortgagees holding the mortgagor's title deeds are anything like strong enough to justify prohibiting mortgagees from holding them. Therefore, the effect of not giving mortgagees a statutory right to hold the title deeds would simply be to add two or three more lines to each mortgage deed.

6.7 However, if mortgagees are to have any right to the mortgagor's title deeds (statutory or contractual) we consider it essential that (as in the present law) they should take responsibility for their safekeeping, and mortgagors should have adequate rights to inspect and take copies of them, and to have them delivered up promptly on discharge of the security.

6.8 Accordingly, we make the following recommendations in relation to the mortgagor's documents of title:

- (a) it should be a statutorily implied provision of a first formal land mortgage that the mortgagee has the same right to possession of the documents relating to the mortgaged interest as if that interest had been assigned to him; this provision should be variable;<sup>7</sup>
- (b) in any mortgage which contains a statutory or contractual<sup>8</sup> right for the mortgagee to possess the mortgagor's documents of title, it should be an overriding<sup>9</sup> provision of the mortgage that (i) the mortgagee shall keep the documents safely and (ii) the mortgagor shall be entitled to inspect and take copies of them at any reasonable time, at his own cost and on payment of the mortgagee's costs and expenses and (iii) the mortgagor shall be entitled to have the documents produced, and to have copies of them, as soon as reasonably practicable. This recommendation is derived from section 96(1) of the Law of Property Act 1925, which contains a provision equivalent to (ii).

### *Insurance*

6.9 The Law of Property Act 1925 contains very limited provisions about insurance of

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<sup>4</sup> For the argument that retention of documents of title by the mortgagee serves to inhibit fraud, see the Second Report of the Conveyancing Committee (1985, H.M.S.O.), para. 4.60.

<sup>5</sup> J. R. Lingard, *Bank Security Documents* (2nd ed., 1988), para. 10.14.

<sup>6</sup> "It has been calculated that the Society would require additional storage space of over one and a half miles if there were an increase of over one tenth of an inch in the bundle of title deeds.": Evidence of the Halifax Building Society, Second Report of the Conveyancing Committee (1985, H.M.S.O.), para. 460.

<sup>7</sup> For the effect of making a provision variable, see para. 3.3 above.

<sup>8</sup> Mortgagees who do not have the statutory right (e.g. second formal mortgagees, or informal mortgagees) may nevertheless acquire possession of the deeds by virtue of a contractual right: if they do, the mortgagor ought to have the same rights as he would have if the deeds were held pursuant to the statutory right.

<sup>9</sup> For the effect of making a provision overriding, see para. 3.3 above.

mortgaged property and they are generally regarded as wholly inadequate by modern standards:<sup>10</sup> consultation confirmed the view expressed in the Working Paper that they do not ensure an acceptable minimum level of insurance of the mortgaged property.<sup>11</sup> Our analysis of standard form mortgage deeds<sup>12</sup> revealed that mortgagees invariably supplement the limited statutory provisions with extensive express provisions, and do so with sufficient uniformity to justify enacting more extensive statutory provisions. Since the function of these provisions would be solely to provide uniform formulations of commonly occurring terms, we consider that the provisions should be variable rather than overriding.<sup>13</sup>

6.10 We received many valuable comments about the content of new statutory insurance provisions, particularly from the Office of Fair Trading and the Association of British Insurers. This consultation has caused us to change the proposals we made in the Working Paper in two significant respects.<sup>14</sup> First, we accept that it is not necessary to confine the provisions wholly to mortgages of freehold (as opposed to leasehold) interests. Secondly, the provisions should not give the mortgagee the option (i) of itself insuring at the mortgagor's cost (except where the mortgagor has defaulted in insuring) or (ii) of requiring the insurance to be maintained in joint names.<sup>15</sup> This would of course not interfere with the freedom of any mortgagee who wanted such provisions to incorporate them by express provision in the mortgage deed, since the statutory provisions would be variable.

6.11 There is one other important point relating to insurance which we consider should not be covered by statutory provision. This is the question of the application of insurance proceeds. Our analysis of standard form mortgage deeds did not show a high level of uniformity in the treatment of this question. The most commonly occurring express provision we found was that the mortgagee could elect whether the insurance proceeds should be used to reinstate the mortgaged property or should be used to pay off the mortgage debt. As we pointed out in the Working Paper, the legal effect of such a provision is uncertain, and in any event it does not always produce a satisfactory result where other parties have an interest in the mortgaged property.<sup>16</sup> We repeat the conclusion tentatively expressed in the Working Paper, that the application of insurance proceeds is a problem which requires consideration in the wider context of insurance of buildings in multi-ownership, and that it would be unsatisfactory to deal with the position between mortgagor and mortgagee in isolation from this wider context.

6.12 In conclusion, we recommend that the following provisions relating to insurance should be implied in all formal land mortgages as variable provisions:

- (a) an obligation on the mortgagor to insure the mortgaged property for such amounts and against such risks as the mortgagee reasonably requires, and to keep up the insurance, but with a power for the mortgagor to take greater cover (in both amount and risk) if it wishes;
- (b) an obligation on the mortgagor to provide the mortgagee on request with such evidence of compliance as the mortgagee reasonably requires;
- (c) an obligation on the mortgagor to notify the mortgagee of any claim on the insurance, and refrain from any act or omission which would invalidate the insurance;
- (d) if the mortgagor is in default of the obligation to insure, a right for the mortgagee to insure for such amounts and against such risks as it reasonably thinks fit, the cost of doing so to be a charge on the mortgaged property.<sup>17</sup>

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<sup>10</sup> See, for example, P. B. Fairst, *Mortgages* (2nd ed., 1980), pp. 118-9.

<sup>11</sup> Paras. 3.27 and 5.38.

<sup>12</sup> Para. 6.2 above.

<sup>13</sup> Para. 3.3 above.

<sup>14</sup> The Working Paper proposals, as changed in these two respects, are comprised in the recommendations we make in para. 6.12 below.

<sup>15</sup> Such provisions would be inconsistent with agreements negotiated by the Office of Fair Trading with various bodies, and so it would not be appropriate to include them as statutory rights, even though variable.

<sup>16</sup> Paras. 3.28 and 5.39.

<sup>17</sup> As in the present law by virtue of Law of Property Act 1925, s. 101(1)(ii).



### *Repair and condition of the property*

6.13 In the present law there are no statutory provisions about repair of the mortgaged property, and such case law as there is concerns mainly the circumstances in which a mortgagee who repairs is allowed to bring the cost into account.<sup>18</sup> Hence, in practice mortgage deeds almost invariably contain express provisions dealing with the mortgagor's obligations in respect of the repair and condition of the property. Our analysis of standard forms, and response to our Working Paper proposals<sup>19</sup> confirm that generally acceptable variable provisions about the mortgagor's duties can be devised. The provisions we recommend should be enacted for this purpose are set out in (a) to (e) of paragraph 6.15 below.

6.14 These provisions are, however, only appropriate for so long as the mortgagor rather than the mortgagee is in possession of the mortgaged property. We recommend below<sup>20</sup> that in the new mortgage a mortgagee should no longer have an inherent *right* to possession of the mortgaged property, but instead should, in some circumstances, be entitled to take possession as a *remedy*, as a means of protecting the security or facilitating its enforcement. The question therefore arises of the responsibility the mortgagee ought to undertake for the upkeep of the property for so long as the mortgagee is in possession for these purposes. In the present law a mortgagee in possession does have some liability to prevent deterioration of the property but the ambit of the liability is unclear.<sup>21</sup> We consider that the liability ought to be clarified, and that, as a matter of principle, a mortgagee who takes possession of the property to protect or enforce the security ought to undertake responsibility for its repair and condition during the period of that possession. We recommend that an appropriate balance to draw between mortgagor and mortgagee is to impose on the mortgagee in possession the same obligations in respect of the repair and condition of the property as those that were imposed on the mortgagor in possession, whether by the variable statutory repairing provisions, or by whatever express provisions the mortgagee chose to impose to replace the statutory provisions. The mortgagee's obligations should, however, be set by reference to the state of repair of the premises at the date when the mortgagee took possession, rather than at the date when the mortgage was granted.

6.15 Accordingly we recommend that the following provisions relating to the repair and condition of the mortgaged property should be implied into all formal land mortgages:

- (a) except while the mortgagee is in possession, the mortgagor should be under a duty (i) to keep the premises in substantially the same state of repair as they were in at the time the mortgage was created and (ii) not to demolish or make any structural alterations to any buildings on the mortgaged property without the mortgagee's consent (such consent not to be unreasonably withheld); this provision should be variable;
- (b) except while the mortgagee is in possession, the mortgagor should be under a duty to comply with all obligations affecting the mortgaged property enforceable by any superior interest holder (such as a trustee or landlord) or by any other person (such as the holder of the benefit of a restrictive covenant), or imposed by an Act of Parliament (for example, planning requirements, preservation orders, fire regulations, etc.), and should be under an obligation to supply to the mortgagee on request such evidence of compliance as the mortgagee reasonably requires; this provision should be variable;
- (c) the mortgagee should have a right to enter the mortgaged property so far as may be necessary (i) to view the state of repair and (ii) to exercise the rights referred to in (d) below, exercisable at reasonable times and after giving reasonable notice; this provision should be variable;
- (d) the mortgagee should have a right, arising if the mortgagor is in breach of any obligation referred to in (a) or (b) above, to carry out whatever works are necessary to remedy the mortgagor's breach at the cost of the mortgagor, such costs to be a charge on the property; this provision should be variable;

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<sup>18</sup> Fisher and Lightwood, *op. cit.*, pp. 50–51 and 370–3.

<sup>19</sup> Para. 5.37.

<sup>20</sup> Para. 6.16 below.

<sup>21</sup> Fisher and Lightwood, *op. cit.*, pp. 368–73; the cases tend to deal with failure by the mortgagee in possession to preserve the value of the property as a breach of the duty to take reasonable care to obtain a proper price on sale (see *Norwich General Trust v. Grierson* [1984] C.L.Y., para. 2306 and *Emmet on Title* (1986), para. 25.043) but the position is complicated by the fact that the courts regard the mortgagee as in possession by virtue of its inherent right rather than in pursuance of a remedy.

- (e) the mortgagee, when in possession, should owe the mortgagor duties relating to the repair of the premises, and to the compliance of obligations affecting them, which correspond to the duties owed to the mortgagee by the mortgagor (whether by virtue of the statutory provisions, or by virtue of any express term of the mortgage) when the mortgagor is in possession; it should not, however, extend to matters which are (or should be) covered by the mortgagor's insurance, and the extent of the mortgagee's obligations should be measured by reference to the state of repair of the premises at the time when the mortgagee took possession, rather than at the time when the mortgage was granted; all the provisions in this subparagraph (e) should be overriding. There is no equivalent statutory obligation at present.

### *Possession*

6.16 One of the consequences of the relationship created by the mortgage by demise and by the charge by way of legal mortgage is that it is the mortgagee and not the mortgagor who is entitled to possession of the property.<sup>22</sup> Unless the mortgage deed expressly restricts the exercise of the right<sup>23</sup> it is exercisable at any time and for any (or no) reason: its exercise is not dependent on any default by the mortgagor, nor on any threat to the security.<sup>24</sup> If the mortgagee prefers to obtain a court order for possession rather than obtain possession extra-judicially<sup>25</sup> the court has power, if the property is a dwelling-house, to withhold or delay the order on condition that the mortgagor remedies any default.<sup>26</sup> Otherwise, the court has no power to regulate the exercise of the right: it is a matter in which equity has consistently refused to intervene.<sup>27</sup> Consultation confirmed the view expressed in the Working Paper that this right is neither needed nor wanted by mortgagees, and that its continued existence is an unnecessary complication in the law:<sup>28</sup> in practice, reputable mortgagees treat the right as a remedy, exercising it only when necessary for the protection or enforcement of the security. We recommend that the law should reflect this practice, and that it should be an overriding provision of a formal and an informal mortgage that the mortgagor is entitled to possession of the mortgaged property, with the mortgagee being entitled to take possession only in specified circumstances for the protection or enforcement of the security. We return to the details of this new remedy of possession for the mortgagee in Part VII of this Report.

### *Powers of leasing*

6.17 This is another area where the present law is complicated by the leasehold or quasi-leasehold relationship created by the mortgage by demise and charge by way of legal mortgage. Since the mortgagee has, or is deemed to have, a long lease which will terminate on redemption, neither the mortgagor nor the mortgagee has the inherent capacity to grant leases or other derivative interests binding on the other.<sup>29</sup> Section 99 of the Law of Property Act 1925 was intended to remedy this situation as far as leases are concerned. It confers powers on whichever party is in possession to grant leases authorised by the section which will be binding on the other party. However, in so far as it confers powers on the mortgagor in possession, section 99 can be, and in practice almost invariably is, excluded or restricted by express provision in the mortgage deed.<sup>30</sup> As a result, a mortgagor in

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<sup>22</sup> This is the case with all property transfer-type mortgages.

<sup>23</sup> It may do so by direct restriction, or indirectly by means of an attornment clause: see further para. 3.23 of the Working Paper. We believe that neither is common.

<sup>24</sup> Fisher and Lightwood, *op. cit.*, pp. 331–334.

<sup>25</sup> This remains perfectly permissible, unless the mortgage secures a regulated agreement under the Consumer Credit Act 1974.

<sup>26</sup> Administration of Justice Act 1970, s. 36, as amended: for detailed criticisms of this jurisdiction see para. 3.69 of the Working Paper. A similar jurisdiction applies to mortgages securing regulated agreements under the Consumer Credit Act 1974, ss. 129–130. See further para. 7.48 below.

<sup>27</sup> It was said by Lord Denning M.R. in *Quennell v. Maltby* [1979] 1 W.L.R. 318, 322–3 that there is an equitable jurisdiction to withhold possession from a mortgagee who does not seek it bona fide and reasonably for the purpose of enforcing the security, but it is difficult to reconcile this with the other authorities: see in particular *Four-Maids Ltd. v. Dudley Marshall (Properties) Ltd.* [1957] Ch. 317; *Birmingham Citizens Permanent Building Society v. Caunt* [1962] Ch. 883; *Western Bank Ltd. v. Schindler* [1977] Ch. 1; *Mobil Oil Co. Ltd. v. Rawlinson* (1981) 43 P. & C.R. 221; *Citibank Trust Ltd. v. Ayivor* [1987] 1 W.L.R. 1157.

<sup>28</sup> Working Paper, paras. 3.23–3.25.

<sup>29</sup> See Megarry and Wade, *op. cit.*, pp. 960–963.

<sup>30</sup> This does not apply to mortgages of agricultural land: s. 99 cannot be excluded in such cases (see Agricultural Holdings Act 1986, s. 100 and Sched. 14, para. 12).

occupation and apparent control of the property usually has no power to grant even short-term occupational tenancies of the property without the consent of the mortgagee,<sup>31</sup> and any tenant under a purported tenancy is liable to be evicted by the mortgagee at will, even if the continued existence of the tenancy does not threaten the value or impede the enforcement of the mortgage.<sup>32</sup>

6.18 Whether under the new mortgage a mortgagor should have power to grant leases without the mortgagee's consent is a question which causes deep divisions between lenders and borrowers. Lenders want mortgagors to have no power to grant leases without the mortgagee's consent, and absolute discretion whether or not to give consent: they feel that the present system gives them an important freedom of action in judging whether a lease proposed by the mortgagor might cause problems in the future, and they point out that it is as much in the mortgagor's interest as it is in the mortgagee's, that the value of the security should not be prejudiced by unwise leases. Borrowers, on the other hand, consider that mortgagees should not be entitled to concern themselves with what happens to the mortgaged property, provided that it is available and of sufficient value if ever the mortgagee needs to have recourse to it, and they point to the unnecessary sterilisation of land that results from over-extensive restrictions on the mortgagor's power to grant leases, and to the real hardship suffered in practice by unauthorised tenants of mortgagors (a problem we return to later<sup>33</sup>). It is obviously desirable to find some compromise between these legitimate but apparently incompatible requirements.

6.19 In our view lenders have not made out a case for being entitled to restrict mortgagors' leasing powers to any extent greater than is necessary to preserve the value of or enforce the security, whether the mortgage is protected or non-protected. Equally, we are satisfied that their interests are not adequately safeguarded unless they can restrict mortgagors' leasing powers to this extent. The solution we recommend is the one proposed in the Working Paper, which we consider draws the most acceptable balance between the conflicting requirements of borrowers and lenders. It is that during the mortgage the mortgagor who is in possession should be free to grant whatever leases it wants, but that when and if the mortgagee becomes entitled to exercise its power of sale, the mortgagee should be free to sell the property free from any lease granted without its written consent.<sup>34</sup> This should ensure that the mortgagee has no right to interfere in the vast majority of cases where the mortgagor does not default and the property remains adequate security for the total indebtedness. Although this will not help the tenant whose mortgagor defaults,<sup>35</sup> it will ensure that the tenant cannot be evicted by the mortgagee simply because of the existence of the tenancy. It should also encourage mortgagors, particularly mortgagors of dwelling-houses, to let property that would otherwise lie vacant. In the case of non-residential property, on the other hand, we do not expect this change in the law to have much effect on current practice, since we assume that most prospective tenants will want a tenancy which is binding on the mortgagee, hence the mortgagor will still have to satisfy the mortgagee that the tenancy is acceptable.

6.20 There are two other matters relating to powers of leasing. The first is that we recommend below, in the context of enforcement of the security, that once a mortgagee takes possession of the property for the purpose of preserving the value or enforcing the security, or appoints a receiver, the mortgagee or receiver should become entitled to grant or accept surrenders of leases in so far as it is reasonably necessary to do so to protect or enforce the security. The second is the problem of a tenant of a defaulting mortgagor whose tenancy is not binding on the mortgagee. Both of these matters are more conveniently dealt with in the context of enforcement of the security, and we return to them in Part VII below.

6.21 In summary, we recommend that there should be implied into all formal land mortgages as overriding provisions:

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<sup>31</sup> Consent, for various reasons, will not necessarily be forthcoming, particularly in the case of residential premises. Mortgagees' traditional reluctance to allow mortgagors of dwelling houses to let the property can be expected to decline as a result of the increased scope for letting to tenants without security of tenure brought about by the Housing Act 1988.

<sup>32</sup> For a detailed explanation see Fisher and Lightwood, *op. cit.*, pp. 358–366, and also *Britannia Building Society v. Earl* [1990] 1 W.L.R. 422 (C.A.) (statutory tenancy not binding on mortgagee).

<sup>33</sup> Para. 7.54 *et seq.*, below.

<sup>34</sup> As in the present law, it will of course be bound by any lease granted before the mortgage, assuming the lease is appropriately protected in accordance with the general law: see Fisher and Lightwood, *op. cit.*, pp. 355–358.

<sup>35</sup> A problem we return to in para. 7.55 below.

- (a) the mortgagor should have power when in possession to grant leases of all or any part of the premises, on such terms and conditions as the mortgagor thinks fit, and a power to accept surrenders of leases; but
- (b) any lease granted by the mortgagor without the written consent of the mortgagee is not binding on the mortgagee.

These powers are much wider than those now granted by section 99 of the Law of Property Act 1925. The present statutory powers can be excluded and, so far as they enable mortgagors to grant leases, often are.

### **Other matters relating to the relationship of the parties during the security**

#### *Transfer of the mortgage*

6.22 The interest of a mortgagee under a formal or informal land mortgage will be a property interest and so *prima facie* alienable without the consent of the mortgagor, unless alienation is specifically restricted by statute. In the present law there are some statutory restrictions on the mortgagee's right to transfer the mortgage without the mortgagor's consent<sup>36</sup> but they are limited in extent: in practice, most mortgagees can transfer or sub-mortgage without reference to the mortgagor.<sup>37</sup> It is only recently that this has come to be of any potential practical significance. Over the last few years a secondary mortgage market has developed in this country, and wholesale dealings in mortgage assets are now relatively widespread.<sup>38</sup> This means that the mortgagee's interest in any particular property may be marketed as part of a bundle of assets to any participant in the international market, without the knowledge or consent of the mortgagor: specifically, it may mean that individuals who originally mortgaged their homes to a household-name building society or British bank may find that their mortgages have been passed on to an overseas company they have never heard of, and which behaves in a way very different from that of the original mortgagee.

6.23 As we explained in the Working Paper,<sup>39</sup> there are three reasons why the identity of the mortgagee might be important to mortgagors, and why mortgagors may therefore be justified in objecting to their mortgages being transferred without their consent. The first is that most secured loans in this country have traditionally been made at interest rates that are unilaterally variable by the lender: until very recently this was almost the invariable practice in the case of house purchase loans.<sup>40</sup> We consider below the extent to which the law should regulate a mortgagee's contractual right to vary interest rates unilaterally, but even as regulated in accordance with our recommendations, the right would still leave the mortgagee with a significant degree of discretion: any mortgagor would be anxious to ensure that a new mortgagee is as likely as the original mortgagee to vary the interest rate in line with fluctuations in United Kingdom market rates. Secondly, in the present law many mortgages entitle the mortgagee to call in the loan at any time after a purely technical default (or even in the absence of default).<sup>41</sup> Again, this is a matter on which we have recommendations to make, particularly in relation to protected mortgages,<sup>42</sup> but there can be no question of totally eliminating the discretion of mortgagees as to whether to treat a default as a minor technical matter or as a matter justifying enforcement. For so long as the mortgagee is a stable institution committed to remaining in the mortgage market in this country, the mortgagor can be reasonably certain that in practice the mortgage will not be enforced in the absence of a real default or threat to the security. However, the position obviously changes if the mortgage is transferred to a less stable mortgagee, or to one not subject to the same market constraints. The third reason is closely connected to the second. Any mortgage system inevitably gives mortgagees a degree of discretion over how to deal with defaults, if only over whether, when and how to enforce the security: different

<sup>36</sup> See Fisher and Lightwood, *op. cit.*, Ch. 14 and para. 3.76 of the Working Paper: the position in relation to building society mortgages has not been significantly altered by the Building Societies Act 1986 (see ss. 93 and 94 on amalgamation or transfer of engagements, and s. 97 for a new provision on the transfer of business from a building society to a commercial company).

<sup>37</sup> The most significant exception is local authority mortgagees, who are subject to the relatively stringent requirements of the Local Government Act 1986, s. 7, which we consider below. This section is reproduced as Appendix E to this Report.

<sup>38</sup> Boleat and Coles, *The Mortgage Market: Theory and Practice of Housing Finance* (1987), Building Societies' Association), Ch. 10.

<sup>39</sup> Para. 3.76.

<sup>40</sup> Fixed rate mortgage loans have become more common since publication of the Working Paper, but are still relatively unusual.

<sup>41</sup> See Working Paper, paras. 3.57–3.62.

<sup>42</sup> Paras. 7.6–7.8 below.

mortgagees adopt different enforcement policies. It must therefore be a matter of concern to mortgagors that their mortgages could be transferred to an institution following a more aggressive and less sympathetic enforcement policy than the original mortgagee.

6.24 Reaction to the Working Paper and developments occurring since its publication have confirmed that the law ought to be reconsidered in the light of this new development, particularly in so far as it affects protected mortgages. A joint Treasury/Department of the Environment Working Group was set up in June 1986 by the then Minister for Housing, Urban Affairs and Construction to look at the range of issues in the emerging secondary mortgage market, including the question of what protection should be given to mortgagors whose mortgages are traded in such a market. It reported in May 1987, concluding that mortgagors did require protection and recommending that this should be achieved by regulating the transfer of mortgages by a voluntary Statement of Practice, a draft of which was set out in the report. The Statement of Practice was not adopted by most banks and building societies, and it now seems unlikely that it will be adopted.<sup>43</sup>

6.25 In its broader context, the secondary mortgage market is outside the scope of this Report. We are not concerned with taking measures to restrain or to encourage or to regulate its growth. Nevertheless, now that it exists, it has been suggested that it is undesirable that mortgagees should be entirely free to transfer their mortgages without any external constraints. We are not much attracted by the idea of regulating this freedom by a voluntary code of practice, even if proves possible to produce a code that the major lending institutions will adopt. As with most issues involving regulation of mortgagees, the major lending institutions are not really the problem: it is those mortgagees who are least likely to adopt and comply with a voluntary code of practice who are most likely, if given the chance, to make outright transfers of their mortgages, with no safeguards for the interests of their mortgagors, to bodies with no incentive to preserve their reputation in the United Kingdom housing market. For this reason we recommend that control over transfers should be by means other than a voluntary code.

6.26 However, we are not in a position to judge whether immediate legislation is the most appropriate way of dealing with this. This is partly because we do not know what the scale of the problem is in practice. Recent press reports indicate that at least some mortgagors are dissatisfied with the treatment they are receiving from organisations which have taken transfers of their mortgages,<sup>44</sup> but we are unable to tell whether these are isolated occurrences or the first indications of a serious, widespread problem. Also, as will be apparent from the succeeding paragraphs, whilst legislation could give most mortgagors a significant degree of control over the identity of their mortgagee, the control can never be complete. It could well be that Treasury or other regulatory control could prove to be a more effective means of ensuring that protected mortgagors are not prejudiced by transfer of their mortgages.

6.27 Our conclusion is that the situation ought to be closely monitored, and consideration should now be given to whether there are effective alternatives to legislation as a means of dealing with this problem. If there are not, and it becomes apparent that a serious practical problem is emerging, we recommend, if the problem is such that transfers should be controlled, that legislation implementing the recommendations we make in the following two paragraphs should be enacted.<sup>45</sup>

6.28 Response to the Working Paper confirmed our conclusion that, if a statutory solution is to be adopted to deal with this problem, it ought to ensure that mortgages cannot be transferred without the informed consent of each mortgagor to that particular transfer: it should not be sufficient to include as a standard term in all mortgage deeds a

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<sup>43</sup> We understand that building societies have drawn up their own code of practice.

<sup>44</sup> Barbara Ellis, *Mortgage misery for thousands with top-up loans*, *The Times* 6 April 1991, and Richard Woods, *Mortgage firm charges 22%*, *The Sunday Times* 7 April 1991. Both reports concern second mortgages transferred to a particular company in late 1990; although bank base rates were then falling, the transferee company increased the rate of interest payable under these mortgages from 18.125% to 22.125%. In that case, it was later suggested that the increases might be in breach of contract.

<sup>45</sup> Clause 47 of the draft Bill annexed as Appendix A to this Report implements these recommendations, but it appears in square brackets, on the basis that the other provisions of the Bill are in no way dependent on it, and could be enacted without it. One possible solution would be to enact cl. 47 as part of this statute, but to make provision for it to be brought into force at a later date. To allow for this possibility, provision (also in square brackets) is made in the Bill for cl. 47 to be given a separate commencement date; see cl. 66(2).

blanket consent by the mortgagor to all future transfers. Consultation also confirmed our conclusion that the best way of achieving this would be to adopt provisions similar to those now applicable to disposal of mortgages by local authorities. These are set out in section 7 of the Local Government Act 1986 and in the Local Authorities (Disposal of Mortgages) Regulations 1986,<sup>46</sup> copies of which are reproduced here as Appendices E and F. For these purposes, some changes to the regulations will be required to ensure that transfers cannot be blocked by mortgagors unreasonably delaying or refusing consent, and that effective sanctions are provided to deal with cases of transfer without consent.

6.29 Accordingly, we recommend that legislation should contain the following provisions:

- (a) a mortgagee under a protected mortgage should not be entitled to transfer the mortgage to any person unless the mortgagor has first given written consent to a transfer *to that person*; this should apply to transferees from the original mortgagee as well as to the original mortgagee;
- (b) regulations, on the lines of the Local Authorities (Disposal of Mortgages) Regulations 1986<sup>47</sup> should prescribe (i) information about the proposed transferee and the transfer which should be supplied to the mortgagor when application for consent is made and (ii) standard form consents and notices of transfer;
- (c) consent should be deemed to be given if the mortgagor does not respond to an application for consent within 28 days: the 28 days should not begin to run until the mortgagee has supplied all the prescribed information;
- (d) if the mortgagor refuses consent unreasonably, the mortgagee should be entitled to go ahead with that transfer without consent;
- (e) consent given or deemed to be given should lapse if the transfer does not take place within six months; however, it should not be possible (as it is under the Local Government Act 1986) for consent once given to be withdrawn within this period (or at all, unless improperly obtained): we consider this to be an unnecessary obstacle in the way of a mortgagee seeking to transfer;
- (f) if a transfer is made without consent, the court should be required (on an application by the mortgagor) to order that the transfer be set aside and the transferor's former interest re-vest in the transferor, if this is practicable; if it is not practicable (because, for example, the transferor is now insolvent) then the maximum rate of interest payable under the mortgage from then on should be that payable at the date when the transferor mortgagee applied to the mortgagor for consent (or should have done so); this sanction is somewhat arbitrary but it should at least provide some safeguard against disproportionate increases in interest rates;
- (g) no consent should be required for dispositions by operation of law (for example, the vesting of mortgages in the personal representatives, or trustees in bankruptcy or liquidators, of deceased or insolvent mortgagees, or any transfer by compulsory purchase).

6.30 We have already explained that these recommendations cannot be expected to give mortgagors total control over the identity of their mortgagees. There are many ways in which the benefit of a mortgage can be transferred without using an outright transfer<sup>48</sup> and such transfers of benefit will not be affected at all by these recommendations. So, whether or not these particular recommendations are implemented (as to which see paragraph 6.26 and 6.27 above), it will not be possible to eliminate all cases where the mortgagee's discretion over such matters as interest rates and enforcement becomes exercisable by someone not chosen by or approved by the mortgagor. There are two obvious ways of minimising any ill-effects of this. The first is to remove any unnecessary obstacles in the way of redemption:<sup>49</sup> we consider this in paragraph 6.42 below. The second is to minimise the importance to the mortgagor of the identity of the mortgagee by narrowing the

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<sup>46</sup> S.I. 1986, No. 1028.

<sup>47</sup> *Ibid.*: see Appendix F to this Report.

<sup>48</sup> e.g. transferring the company nominally holding the mortgages from the transferor to the transferee, or simply by sub-mortgaging.

<sup>49</sup> One of the complaints reported in the cases referred to in n. 44 to para. 6.26 above, was that whereas the original mortgagee charged an administration fee of £12 for premature redemption, the transferee mortgagee was asking for a fee of up to £75.

mortgagee's discretion over interest rates and enforcement: the feasibility of doing so is considered below.<sup>50</sup>

#### *Transfer of the mortgagor's interest*

6.31 In the present law the mortgagor's interest in the mortgaged property is freely alienable, subject to any express restriction imposed in the mortgage deed.<sup>51</sup> Nevertheless, transfer of the mortgagor's interest subject to the mortgage is comparatively rare in this country. Although the practice of transferring the mortgage is not unknown,<sup>52</sup> it remains very much more common for vendors to discharge their mortgages out of the sale proceeds and then sell free from mortgages, and for the purchasers to then grant a new mortgage, probably to a different mortgagee. In the Working Paper we questioned whether this was caused by defects in the law, in particular by the absence of privity of contract between the mortgagee and the mortgagor's transferee, and the continuing liability of the original mortgagor. The problems arising can be avoided by the mortgagor, transferee, and mortgagee all entering into a deed of covenant on a transfer subject to the mortgage, and in the Working Paper we invited comments on whether the law ought to be changed, either by making some such procedure mandatory, or by providing that a transfer of sale made with the consent of the mortgagee (not to be unreasonably withheld) should automatically operate to release the transferor from all liability and make the transferee fully liable.<sup>53</sup> However, consultation confirmed our tentative view that the actual (as opposed to theoretical) problems here were not sufficient to justify making such changes. Accordingly, we recommend that under a formal land mortgage there should be no statutory restriction either on the mortgagor's ability to transfer his interest subject to the mortgage, or on the mortgagee's right to restrict the exercise of that power by provision in the mortgage deed.

#### *Regulation of interest rates*

6.32 There are two issues concerning the financial relationship of the parties during the security that can conveniently be dealt with here. These relate to interest rates payable under the mortgage. Although we recommend in Part VIII of this Report that the courts should have a general jurisdiction to set aside or vary any term of a mortgage, we consider that specific provisions are required to deal with these two matters.

#### *Increase of rate of interest on default*

6.33 The first concerns the validity of a mortgage provision requiring the rate of interest payable under the mortgage to be increased on default. It is specifically provided by section 93 of the Consumer Credit Act 1974 that such a provision is void in a mortgage securing a regulated agreement. In the case of other mortgages the validity of a provision requiring interest rates to be increased on default is in some doubt in the present law. Traditionally it was considered to be void as a penalty,<sup>54</sup> but easily circumvented by reserving the higher rate as the rate normally payable and providing for its reduction in case of prompt repayment.<sup>55</sup> More recently, the view has been expressed that a provision directly increasing interest on default would no longer be held void "provided it is kept within proper commercial bounds".<sup>56</sup> The tentative view expressed in the Working Paper was that a rule that was so easily circumvented was undesirable, and we suggested that either all increases on default and reductions for prompt payment should be prohibited in all mortgages, or section 93 of the 1974 Act should be abolished, leaving all such provisions to be dealt with under the court's new general jurisdiction we deal with in Part VIII of the Report. Neither of these suggestions found favour with those respondents who commented on the point. It was generally considered that the present law, uncertain though it may be, operates satisfactorily in commercial cases, although no disquiet was expressed at the thought that such provisions might also be challenged under the new general jurisdiction.

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<sup>50</sup> See paras. 6.35 *et seq.* below on interest rates, and Part VII below on enforcement.

<sup>51</sup> Law of Property Act 1925, s. 95.

<sup>52</sup> See, for example, the transfer of equity scheme referred to in the Working Paper, para. 3.77, n. 232.

<sup>53</sup> Para. 9.43.

<sup>54</sup> P. K. J. Thompson, *Recovery of Interest: Practice and Procedure*, (1985), p. 14.

<sup>55</sup> See Fisher and Lightwood, *op. cit.*, 654-5. It is uncertain whether the Consumer Credit Act 1974, s. 93 can be circumvented by such a provision: a disincentive would presumably be that the higher rate would have to be used for the purposes of calculating the A.P.R. (annual percentage rate, representing the true rate of charge).

<sup>56</sup> J. R. Lingard, *Bank Security Documents* (2nd ed., 1988), para. 7.42.

In the case of non-commercial mortgages, however, the Office of Fair Trading and consumer organisations felt strongly that a provision equivalent to section 93 was essential, and in fact ought to be extended to apply to all protected mortgages. They also felt that deductions for prompt payment were not an issue in residential cases, so they saw little point in extending the scope of section 93 in that way.

6.34 We therefore recommend that in all protected mortgages, a provision that purports to increase the rate of interest payable on default should be void, and that in non-protected mortgages such a provision should be challengeable only under either the general law concerning penalties, or under the general jurisdiction we describe in Part VIII.

#### *Regulation of variable interest rates*

6.35 The second issue concerning interest rates is whether there should be any restriction on the power mortgagees have in the present law to reserve to themselves an unfettered right to vary unilaterally the rate of interest payable under the mortgage. We have already referred to the fact that in this country unilaterally variable interest rates have been the norm for many years.<sup>57</sup> In the Working Paper we explained why the present law provides no satisfactory method by which a mortgagor can challenge the decision of a mortgagee to vary the interest rate, or refuse to vary following a fall in market rates.<sup>58</sup> The equitable jurisdiction to set aside “unfair and unconscionable” terms is unlikely to be of any help, because it has been confined to cases where an offending term was originally imposed “in a morally reprehensible manner”,<sup>59</sup> whereas the interest rate has been changed (or not changed) pursuant to a right routinely included in all mortgages. The same difficulty would arise on any attempt to use the extortionate credit bargain provisions of the Consumer Credit Act 1974<sup>60</sup> with the added problem that the courts have shown great reluctance to declare interest rates “extortionate” for the purposes of this jurisdiction unless the rate charged exceeds the market rate<sup>61</sup> by a very considerable amount.<sup>62</sup> In practice, therefore, mortgagors must rely on market forces to deter their mortgagees from allowing the interest rate to move far from market rates. The issue here is whether market forces provide adequate safeguards for mortgagors, or whether the law ought to provide the mortgagor with an effective means of challenging interest rates. Again, this is a matter of particular concern to protected mortgages. Until relatively recently the residential mortgage market has been stable in this country, and dominated by relatively few domestic lending institutions with every incentive to remain competitive in the market. However, in recent years the range of lending institutions participating in the residential mortgage market as primary lenders has increased, and whilst all lenders operating in the country are subjected to the same financial controls, nevertheless, those who are primarily based in other jurisdictions do not necessarily have the same commitment to remaining competitive in the British residential mortgage market. The problem is compounded by the growth in the secondary mortgage market we referred to above. Whilst it may be justifiable to leave total discretion over interest rates with a mortgagee chosen by the mortgagor (however ill-advisedly), there are obvious objections to allowing a transferee of the mortgage to enjoy the same discretion if the mortgagor has no control over the identity of the transferee.

6.36 In the Working Paper we put forward for consideration several different ways of dealing with this issue. The reaction to these suggestions on consultation was varied. The dangers of interfering with the ability of lenders to respond to market forces were pointed out most forcefully, and we recognise the importance of this factor. Nevertheless, we do

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<sup>57</sup> For an explanation and description of this phenomenon, and a comparison with other jurisdictions, see Boleat and Coles, *The Mortgage Market: Theory and Practice of Housing Finance* (1987, Building Societies' Association), Ch. 8.

<sup>58</sup> Para. 9.8.

<sup>59</sup> *Per Brown-Wilkinson J. in Multiservice Bookbinding Ltd. v. Marden* [1979] Ch. 84, 110.

<sup>60</sup> See Working Paper, para. 3.38.

<sup>61</sup> The courts have made it clear that, “the market rate” means the rate chargeable in the market by this sort of lender to this sort of borrower in these circumstances, thus sanctioning high rates charged to high risk borrowers: see in particular *A. Ketley Ltd. v. Scott* [1981] 1 C.R. 241.

<sup>62</sup> In *Davies v. Directloans Ltd.* [1986] 1 W.L.R. 823, 837, Edward Nugee Q.C. sitting as a deputy High Court judge said that the difference between 21.6% (the rate charged) and 18% (submitted to be proper) was not “anywhere near large enough” to be considered grossly exorbitant, and hence extortionate for the purposes of the Consumer Credit Act 1974. In the transfer of mortgage cases discussed in the press reports noted in n. 44 to para. 6.26 above, the mortgagors complained of an increase in interest rate from 18.125% to 22.125%, albeit made at a time when bank base rates were falling. See further Working Paper, para. 3.38.



not consider that it need rule out all possibility of any control over the right to vary interest rates. For example, it has no relevance to the first of the suggestions we put forward, which was merely that one of the uncertainties in the present law should be removed.<sup>63</sup> As we explained in paragraph 6.35 above, one of the reasons why variations in interest rates probably cannot be challenged in the present law is that the appropriate jurisdictions look only at whether the mortgage was “unconscionable” or “extortionate” at the time the mortgage was created. The first suggestion we made in the Working Paper was that, in considering whether to exercise the new jurisdiction to set aside or vary terms of the mortgage (dealt with in Part VIII of this Report) the court should consider whether the mortgage has *become* objectionable as a result of a variation of, or failure to vary, the interest rate, even if the mortgage fully entitles the mortgagee to vary or not vary as it chooses. No specific argument was put against this suggestion,<sup>64</sup> and accordingly we recommend that it should be adopted, and that it should apply to both protected and non-protected mortgages.

6.37 This, however, would only deal with cases where the interest rate has become grossly out of line with market rates. In the case of non-protected mortgages we consider that this is as far as regulation should go. In the case of protected mortgages, on the other hand, we take the view (shared by most of those who responded to the Working Paper) that mortgagors have a legitimate expectation that their interest rates will be kept at least roughly in line with what reputable lenders in the market are charging for comparable loans. We also take the view (also widely endorsed, though not to the same extent) that the law has some role in ensuring that this expectation is fulfilled. Out of the other suggestions we put forward in the Working Paper for dealing with this, there was general agreement with our tentative view that controls of the sort described in Working Paper paragraphs 9.8(b) (statutory maximum interest rates) and 9.8(c) (putting the onus on the lender to justify any rate higher than a specified rate) were undesirable. Lenders in particular argued that statutorily specified interest rates, however used, are too inflexible given the wide fluctuations in interest rates that have occurred over recent years. Also, both lenders and consumer organisations shared the fears expressed that statutory maximum rates tend to be viewed by some lenders as standard rates.

6.38 The suggestion put in paragraph 9.8(c) of the Working Paper was more favourably received. This was that mortgagees should be required to link variations in interest rate to some objective index, such as the London Inter-Bank Offer Rate, and be required to limit variations in the rate they charge within a fixed margin of that index. We suggested that the index could either be specified in the mortgage deed, or selected by the mortgagee from time to time out of a list of approved indices maintained by an official body for this purpose. It was generally agreed that such a system was feasible, and some lenders considered it the least undesirable of all the suggestions put forward. Our own conclusion, however, is that for reasons of efficiency and flexibility, the more general approach suggested in paragraph 9.8(e) of the Working Paper is preferable.

6.39 The approach suggested in paragraph 9.8(e) of the Working Paper, which is the one that we recommend should be adopted, is that a protected mortgagor should be entitled to challenge a variation in (or failure to vary) the rate of interest payable under the mortgage on the ground of unreasonableness, with reasonableness being decided by reference to market rates of interest charged for comparable loans. There were two major objections to this. The first was that it was thought to be too vague: lenders in particular are anxious not to be required to observe restrictions of uncertain ambit. We appreciate this fear, but consider that it can be met by defining “unreasonable” with some precision. What we recommend is that a variation in (or failure to vary) the interest rate charged should be *prima facie* unreasonable if the original differential between the rate charged and the market rate for comparable loans<sup>65</sup> is significantly increased. We recommend that this should be done by directing the court, in considering whether a variation or failure to vary

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<sup>63</sup> The first suggestion is set out in Working Paper, para. 9.8(a).

<sup>64</sup> In other words, it was opposed only on the ground that, in view of the danger of upsetting the market, all restrictions of any description whatsoever on lenders’ discretion over interest rates should be avoided.

<sup>65</sup> By “market rate for a comparable loan” we mean the rate of interest that reputable lenders would charge borrowers in similar personal and financial circumstances for a loan on similar terms made in similar circumstances.

is unreasonable, to have particular regard to the difference between the rate charged under the mortgage and the current market rate charged for comparable loans,<sup>66</sup> both at the time when the mortgage was created and at the time when the mortgagor makes his complaint. We also recommend that the onus should be on the mortgagor to satisfy the court that the variation or failure to vary is unreasonable.

6.40 The other objection put to the proposal that variations in interest rate should be challengeable on the ground of unreasonableness, was the general objection we referred to at the beginning of paragraph 6.36 above: that any interference with the ability of lenders to respond to market forces is undesirable. We are sceptical that our recommendation could have this effect: by tying “reasonableness” to current market rates for comparable loans, lenders will be encouraged to respond to market forces, rather than frustrated in attempts to do so. Nevertheless, we accept that it would be desirable to keep the matter under review. We recommend that this should be done by giving the Office of Fair Trading power to exempt specified lenders from this provision, and to keep the list of exempt lenders under review. This should ensure that lenders who keep in line with market rates need not be concerned about challenges from individual mortgagors, and it might also provide other lenders with an incentive to keep to market rates.

6.41 In summary, our recommendations about regulating variable interest rates are as follows:

- (a) in the case of all mortgages, the court should have jurisdiction to vary interest rates on the grounds described in Part VIII below if the mortgage has become challengeable because of a variation of or failure to vary the rate of interest payable, even if the mortgagee had quite properly reserved in the mortgage deed the right to vary the interest rate payable;
- (b) in the case of protected mortgages, the court should be entitled, on application by the mortgagor, to alter the interest rate payable, if satisfied by the mortgagor that the mortgagee has unreasonably varied or failed to vary the interest rate;
- (c) in order to assess whether a variation or failure to vary is unreasonable, the court should be directed to have particular regard to the difference between the rate complained of and the current market rate charged for comparable loans, and the ratio that this bears to the difference between the rate originally charged and the then market rate;
- (d) the Office of Fair Trading should have power to exempt such lenders as it from time to time thinks fit from the effect of (b) and (c) above.

### *Redemption*

6.42 Although we recommend below the abolition of the equitable jurisdiction to set aside any provision of a mortgage which constitutes a clog or fetter on the equity of redemption,<sup>67</sup> we do not intend to interfere with the equitable right to redeem. In other words, under a formal or informal land mortgage (as in any other mortgage or charge over any other kind of property) the mortgagor will remain entitled to redeem the property freed from the mortgage by paying and discharging all obligations under it, even after the contractual date for payment and discharge has passed, up until the time when the mortgagor’s interest is destroyed by a sale by the mortgagee.<sup>68</sup> In the case of protected mortgages, we consider that further steps should be taken to ensure that redemption and discharge are not discouraged or penalised. In our view this is particularly important because of the lack of control protected mortgagors have over the identity of the mortgagee and over the rate of interest from time to time charged. We make recommendations in paragraphs 6.23 to 6.31 and 6.35 to 6.41 respectively for increasing their control. Nevertheless, mortgagees must inevitably retain a significant degree of discretion in both areas, and ultimately the only recourse of mortgagors dissatisfied with their mortgagees, or with the rate of interest charged, is to redeem the mortgage and borrow elsewhere. Whilst a shortage of mortgage funds may often make the right to redeem illusory in practice, we

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<sup>66</sup> Using “comparable loan” in the sense explained in the previous note.

<sup>67</sup> This is to be replaced by a statutory jurisdiction: see Part VIII below.

<sup>68</sup> See generally Fisher and Lightwood, *op. cit.*, Ch. 28.

take the view that, in the case of protected mortgages, no restriction on the right to redeem at any time ought to be permitted.<sup>69</sup> Although most lenders would prefer to retain the flexibility of being able to impose whatever terms they consider appropriate in relation to redemption, they made no very strong objections to the provisions which we proposed in the Working Paper and recommend here, and which were strongly supported by consumers' organisations. Also, it should be noted that mortgagors whose mortgages secure regulated agreements under the Consumer Credit Act 1974 are already entitled to discharge the mortgage at any time.<sup>70</sup>

6.43 Accordingly we recommend that in the case of protected mortgages:

- (a) any term of the mortgage which postpones the mortgagor's right to redeem should be void, unless the property includes non-residential premises (in which case the postponement of the right to redeem should be dealt with in the same way as in non-protected mortgages, that is subject to challenge under the court's general jurisdiction: see Part VIII below);
- (b) any term of the mortgage which requires the mortgagor to give notice of intention to redeem, or requires payment of interest in lieu of notice, should be void: such provisions, which were once very common in residential mortgage deeds although now not in regular use by institutional lenders, impose a financial penalty on mortgagors who want to repay early;
- (c) mortgagors whose repayments are calculated on the basis of the loan remaining outstanding for a specified period should be entitled to the appropriate rebate on earlier repayment; this should be dealt with by regulations similar to those currently achieving the same objective in relation to mortgages securing a regulated agreement under the Consumer Credit Act 1974.<sup>71</sup>

#### *Consolidation*

6.44 There is a further restriction on redemption that we recommend ought to be removed, although as far as we know it causes few practical problems. This is the doctrine of consolidation, whereby a mortgagee who holds two or more mortgages created by the same mortgagor over different properties, has an equitable right to refuse to allow one mortgage to be redeemed unless the other or others are redeemed.<sup>72</sup> It can apply even when the equities of redemption have become vested in different mortgagors, and even if the mortgages were originally granted to different mortgagees. This makes the doctrine a trap for purchasers of property subject to a mortgage (in theory at least) since there is no way of establishing whether the vendor has created mortgages over other property which may be, or later become, vested in the mortgagee of the purchased property. This is not the only criticism that can be made of it: in Megarry and Wade the following view is expressed:

In practice, the right to consolidate causes less trouble than might be supposed. But as a source of risk to an innocent purchaser it is a freak of equity; it is "not one of those doctrines of the Court of Chancery which has met with general approbation". There may well be doubts as to the wisdom of equity allowing a mortgagee who has made two distinct bargains, one good and one bad, to use the success of one to rescue him from the failure of the other. (*op. cit.* at pp. 959-960)

The mortgagee's right to consolidate was removed by statute in 1881,<sup>73</sup> but only "if and so far as a contrary intention is not expressed" in any of the mortgage deeds in question. In practice, the operation of the section appears to be almost invariably expressly excluded in mortgage deeds. It is not obvious why mortgagees still choose to retain the right to consolidate. Mortgagees who want to take several mortgages from the same mortgagor over different properties can (and do) achieve a similar effect by charging each property with repayment of the total indebtedness. This leaves the mortgagee in as strong a position in

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<sup>69</sup> The issues are different in the case of non-protected mortgages. As the courts have recognised in modern times (see in particular *Knightsbridge Estate Trust Ltd. v. Byrne* [1939] Ch. 441) the length of time during which the loan is to remain outstanding is just one term in a financial transaction made at arm's length, and is only objectionable if it was imposed or operates oppressively or unconscionably. Accordingly, in the case of non-protected mortgages we recommend below that objections to postponement of redemption should be dealt with under the court's new general jurisdiction to set aside or vary terms of a mortgage: see Part VIII below.

<sup>70</sup> Consumer Credit Act 1974, s. 94: see Working Paper, para. 3.40.

<sup>71</sup> See s. 95 of the 1974 Act, and the Consumer Credit (Rebate on Early Settlement) Regulations 1983, S.I. 1983, No. 1562 as amended by S.I. 1989, No. 596.

<sup>72</sup> For a full explanation see Megarry and Wade, *op. cit.*, pp. 955-960.

<sup>73</sup> Conveyancing Act 1881, s. 17: see now Law of Property Act 1925, s. 93.

relation to the mortgagor, and it has the considerable advantage over consolidation (from the point of view of everyone else) that it cannot trap third parties. In the Working Paper<sup>74</sup> we asked for evidence as to whether the right to consolidate was ever now exercised, and comments on whether it was thought still to fulfil any useful purpose. Whilst some lenders were reluctant to see the right abolished, no convincing argument was put that it serves any useful purpose. We therefore recommend that, in the interests of simplifying the law, the right to consolidate should be abolished.

### *Discharge*

6.45 There was general agreement on consultation with the view we expressed in the Working Paper<sup>75</sup> that the rules governing the discharge of formal and informal land mortgages should be essentially the same as those presently applicable, but with some simplifications. Some of these simplifications have already been made.<sup>76</sup> In the light of this the recommendations we make are as follows:

- (a) as in the present law, a mortgage should be discharged by the mortgagor discharging all his liabilities under it: no document should be necessary in order to complete the discharge (subject to the need to make a cancellation in the register in the case of a registered charge in registered land<sup>77</sup>);
- (b) a simple standard form discharge should be provided by statutory instrument, after consultation with institutional lenders and the Land Registry: should it be necessary, different standard forms should be produced to suit different circumstances (although we would hope that the number of forms would be kept to a minimum);<sup>78</sup>
- (c) use of the standard forms should not be mandatory, but if the standard form is used it should operate as a good receipt for the money due under the mortgage, and a purchaser should be entitled to rely on it as sufficient evidence of discharge.

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<sup>74</sup> Para. 9.41.

<sup>75</sup> Para. 9.45.

<sup>76</sup> See Land Registration Rules 1925, S.R. & O. 1925 No. 1093, r.151, as amended by the Land Registration (Charges) Rules 1990, S.I. 1990, No. 2613, which makes significant changes to the procedure for discharging registered charges.

<sup>77</sup> Land Registration Act 1925, s. 35.

<sup>78</sup> In line with our recommendation which involves repealing the special legislation concerning the discharge of building society mortgages (Building Societies Act 1986, Sched. 4, para. 2), consideration will need to be given, after appropriate consultation, to repealing other provisions relating to particular lenders: e.g. Industrial and Provident Societies Act 1965, s. 33; Friendly Societies Act 1974, s. 57.

## PART VII

### ENFORCEMENT OF THE SECURITY

#### Introduction

7.1 In this Part of the Report we consider what remedies should be available to formal land mortgagees to enable them to protect and enforce the security when it becomes necessary to do so, and the circumstances in which the remedies should be exercisable. We also consider the procedure that should be followed on enforcement of the security, and the jurisdiction of the court to delay or withhold enforcement. We do not deal here or elsewhere in this Report with the mortgagee's right to sue for recovery of the sums secured by the mortgage: our intention is that this right should continue to be governed by the general law,<sup>1</sup> which we believe will not be affected by our recommendations.

7.2 We have already dealt with enforcement of informal mortgages: as we explained in paragraph 3.10 above, our recommendation is that informal mortgagees should have no right to enforce the security, nor to take any other action in relation to the mortgaged property. Instead, their rights should be confined to the right to have the mortgage perfected (in other words to have a formal land mortgage granted to replace the informal mortgage).

7.3 On protection and enforcement of the security, as on the exercise of any other rights, remedies and powers by the mortgagee, we intend that the general limitation we explained in paragraph 3.3 above should apply. In other words, the rights, remedies and powers the mortgagee has, whether derived from these new statutory provisions or from contract, or from elsewhere, are exercisable only in good faith and for the purposes of protecting or enforcing the security.

#### The Remedies

7.4 The remedies available to a legal mortgagee in the present law for the protection and/or enforcement of the security are sale, foreclosure, possession,<sup>2</sup> and appointment of a receiver. In addition, the mortgagee when in possession, and a receiver, can grant leases of the property in order to protect its value. We consider that all of these, with the exception of foreclosure, should be available to formal land mortgagees: our detailed recommendations about each of these remedies are set out in the following paragraphs.

#### Power of sale

7.5 In the present law a mortgagee whose mortgage is made by deed has a statutory power of sale.<sup>3</sup> What the mortgagee actually has power to sell is the mortgagor's estate or interest in the mortgaged property, free from the mortgagee's own mortgage and from subsequent mortgages and other interests to which the mortgage has priority, but subject to all prior mortgages and interests taking priority over the mortgage.<sup>4</sup> We recommend that a formal land mortgagee should be given by statute a power of sale substantially the same as this present statutory power: the differences we recommend will be apparent from the following paragraphs. As in the present law, the statutory power of sale should be variable (that is the mortgagee should be free to supplement or replace it with contractual powers) but statutory restrictions on the exercise of the power should apply also to any contractual powers.

#### *When the power becomes exercisable*

7.6 In the present law the mortgagee becomes entitled to exercise the statutory power of sale in the circumstances provided by sections 101 and 103 of the Law of Property Act 1925, as varied by any express power in the mortgage deed. What these sections do is to set up a two stage procedure, whereby the power of sale *arises* when "the mortgage money has become due"<sup>5</sup> but does not become *exercisable* unless and until there has been a default or breach of covenant sufficient to satisfy section 103 (as amended or replaced by express

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<sup>1</sup> See Fisher and Lightwood *op. cit.*, Ch. 17.

<sup>2</sup> Strictly a right rather than a remedy, but in practice used as a remedy: see para. 6.16 above.

<sup>3</sup> Law of Property Act 1925, s. 101(1)(i).

<sup>4</sup> *Ibid.*, s. 104(1).

<sup>5</sup> Law of Property Act 1925, ss. 101(1)(i) and 101(1)(iii).

provision in the mortgage deed). In the Working Paper we criticised both the logic and the operation of this two stage procedure.<sup>6</sup> In particular, it fails to distinguish genuine default justifying enforcement of the security, and it encourages mortgagees to draft mortgage deeds in such a way that mortgagors are artificially put in technical default almost at the outset. As we said in the Working Paper, this not only contributes towards making the mortgage deed incomprehensible, it also defeats the object of having a two stage procedure, since the first stage is artificially accelerated to occur more or less as soon as the mortgage is created.

7.7 We therefore recommend that this procedure should be abandoned, and should be replaced by new rules based on the proposals made in paragraphs 9.28 to 9.38 of the Working Paper, which received general support on consultation. In considering the details of the new system, the guiding principle we have adopted is that the primary requisite of an enforcement system is that the security should not be enforced unless the mortgagor fails to keep to the repayment bargain originally agreed or for some other reason (not necessarily the fault of the mortgagor) the mortgaged property is or threatens to be no longer adequate security for the obligations secured. Since this principle is, in our view, fundamental to the idea of security, provisions designed to enact the principle should be overriding, whether the mortgage is protected or non-protected. There are also other objectives to keep in mind. The first is that the rules should be sufficiently clear and simple to enable the parties, and purchasers from them, to identify without difficulty when the power of sale has become exercisable. Secondly, the definition of the events on which the power becomes exercisable should be sufficiently flexible to take account of the many different types of mortgage and the different purposes for which they are granted: this is particularly important when the provisions are to be overriding. Thirdly, in the interests of all parties, enforcement by mortgagee's sale should operate as efficiently, cheaply and quickly as is consonant with the need to ensure that mortgagors are given an appropriate opportunity to avert avoidable sales by remedying defaults or removing threats to the security. The balance to be drawn here between keeping the system cheap and efficient and providing adequate safeguards for mortgagors will not necessarily be the same in the case of all mortgages.

#### *Enforceable events*

7.8 With these principles in mind, the system we recommend is as follows. There should be no initial stage at which the power of sale arises. Instead, there should be an overriding provision implied in all formal mortgages (protected and non-protected) that the mortgagee shall have a power of sale which is only exercisable if:

- (a) there has been some financial default (which has not been remedied) consisting of a failure to comply with a financial obligation at a time when it was originally intended that the obligation would be met; the object is to include all types of payment default (for example relating to interest, or capital, or insurance premiums) but, by linking it to the original intentions of the parties, to exclude mere technical default; or
- (b) there has been some non-financial default consisting of a failure to comply with a non-financial obligation in circumstances where the failure creates a substantial risk to the value or availability of the security, and the risk has not been removed; the object is to permit sale where the breach of obligation represents a real threat to the security but to prevent enforcement where the breach is trivial and/or remediable; or
- (c) some other event has occurred which creates a substantial risk to the mortgagor's ability to comply with a financial obligation or to the value or availability of the security, and the risk has not been removed; the intention here is to include miscellaneous events (such as compulsory acquisition, impending insolvency, or a fall in the value of the mortgaged property) which affect either the mortgagor's financial standing or the value of the security, but do not necessarily involve any element of default on the part of the mortgagor.

For convenience, we refer to these events as "enforceable events" in the following paragraphs. These recommendations reproduce the restrictions on the statutory power of sale in section 103 of the Law of Property Act 1925, and extend them by taking account of threats to the lender's security.

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<sup>6</sup> Paras. 3.57–3.63.

7.9 We have two additional observations to make about these events. First, it should be noted that the ability of lenders to require loans to be repayable on demand is not affected. If it is genuinely intended that the mortgagee shall be entitled to call in the loan at any time, failure by the mortgagor to repay the total amount outstanding on demand will constitute a default within paragraph (a) above. We did consider whether on demand loans should be confined to non-protected mortgages, but concluded that this would not be desirable. There are many circumstances in which protected mortgagors may want to borrow money which, in practice, is only available if repayable on demand (for example, loans by trustees who can only lend on such terms, or business or other bank overdrafts secured on the mortgagor's home). We would however expect the implications of such a provision to be clearly explained in the mortgage deed in the case of protected mortgages.<sup>7</sup> Also, any exercise of the mortgagee's power to call in the loan at any time will be subject to the general limitation on the exercise of the mortgagee's rights, remedies and powers that we recommend in paragraph 3.4 above: we consider that this general limitation that powers must be exercised in good faith and for the purposes of protecting or enforcing the security will provide an adequate safeguard against capricious or improper exercise of the mortgagee's power to call in the loan at any time.

7.10 The second point is that some disquiet was originally voiced by consumers' associations that a protected mortgage might be enforced under (c) above even though the mortgagor remained able and willing to keep up the mortgage repayments. However, it should be noted that on an application to enforce a protected mortgage, the court will have the powers to regulate enforcement that we describe below;<sup>8</sup> these powers should enable the court to refuse enforcement in such circumstances.

#### *Additional requirements for protected mortgages*

7.11 There was general agreement on consultation with the provisional view we expressed in the Working Paper<sup>9</sup> that non-protected mortgages should not be subject to any additional restrictions on the exercise of the power of sale. In the case of protected mortgages, however, there are two additional requirements that we recommend ought to be satisfied before the mortgagee is entitled to exercise the power of sale. The first is that the mortgagee must have served a prescribed form enforcement notice on the mortgagor. The second is that the mortgagee must have obtained a court order.

#### *Enforcement notice procedure*

7.12 An enforcement notice procedure already operates in relation to mortgages securing regulated agreements under the Consumer Credit Act 1974.<sup>10</sup> In the Working Paper we invited comments on whether a similar system should apply to all protected mortgages,<sup>11</sup> and in particular whether the administrative costs involved were thought to be justified. Consultation revealed considerable support for the adoption of such a procedure for all protected mortgages, and indeed many respondents considered that it merely enshrined current good practice already observed by many lenders. Significantly, it appeared to be acceptable to lenders with experience of the workings of the Consumer Credit Act procedure. Accordingly, we recommend that such a procedure should be adopted for all protected mortgages.

7.13 The procedure we recommend is as follows. A mortgagee under a protected mortgage who wishes to exercise the power of sale (or take any other enforcement action) should first be required to serve an enforcement notice on the mortgagor. The enforcement notice would not be valid unless at the time of service an enforceable event had occurred and was still operative. In the notice, which would be required to be in a standard form to be prescribed by statutory instrument, the mortgagee would be required to specify:

- (a) the date of the notice;
- (b) the precise nature of the enforceable event on which the mortgagee relies;
- (c) the action (if any) that the mortgagee requires the mortgagor to take in order to

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<sup>7</sup> This is one of the matters we would expect to be covered in the regulations prescribing information to be included in protected mortgage deeds: see para. 5.9 above.

<sup>8</sup> See paras. 7.48 to 7.53 below.

<sup>9</sup> Paras. 9.34–9.35.

<sup>10</sup> Consumer Credit Act 1974, ss. 76, 87–89 and 98, and see also the Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983, S.I. 1983, No. 1561, as amended by S.I. 1984, No. 1109.

<sup>11</sup> Paras. 9.36–9.37.

remedy any default constituting the enforceable event, and the date by which such action should be taken; (this will not be appropriate if the event did not involve any default on the part of the mortgagor);

(d) the effect of service of the notice, including the possible consequences of failure to carry out action specified in (c);

(e) where help and advice can be obtained.

The enforcement notice is designed to serve two purposes: in addition to being a preliminary step in the process of enforcement, it encourages mortgagees to make contact with defaulting mortgagors at an early stage. Thus, the service of the notice may in practice avert the need for enforcement, either because the mortgagor takes the action required, or because negotiations are opened between the parties.<sup>12</sup> After serving notice, if the action specified has not been taken, or if there is no action to be taken because the enforceable event involved no default on the part of the mortgagor, then the mortgagee will become entitled to apply to the court for sale, or for whatever enforcement action is required. If, on the other hand, the specified action is taken, or for some other reason the enforceable event is no longer operative, the power of sale ceases to be exercisable.<sup>13</sup> All provisions relating to the enforcement notice procedure are, of course, intended to be overriding.

#### *Extra-judicial enforcement*

7.14 If enforcement action has to be taken, it is usually cheaper and more efficient if it can be done without the involvement of the court. One of the great attractions of the power of sale in the present law is that the mortgagee is able to procure a sale of the property with overreaching effect without recourse to the court. Consultation confirmed that in the case of non-protected mortgages the power to sell (and appoint a receiver) extra-judicially is widely exercised and greatly valued, and no convincing reason why these powers should be restricted was put forward. The position is, however, different in the case of protected mortgages. Whilst mortgagees remain entitled to exercise the power of sale without a court order, except where the mortgage secures a regulated agreement under the Consumer Credit Act 1974,<sup>14</sup> in practice they are unlikely to exercise the power of sale without first applying to the court for a possession order. This is because if the mortgagor consents to a sale, it will usually be preferable for the sale to be made by the mortgagor rather than in exercise of the mortgagee's power. If on the other hand the mortgagor objects to the sale, the mortgagee will want to obtain a possession order to ensure that vacant possession can be given on completion of the sale. Lenders who responded to the Working Paper on this point confirmed that in practice they are only likely to sell without a court order if the mortgagor has disappeared or abandoned the property and refuses to co-operate in a sale.

7.15 Many of those who responded to the Working Paper felt strongly that a court order ought always to be obtained before any enforcement of a protected mortgage. This view was not confined to consumer organisations, and several lenders had no comment to make on the point other than that this is what happens in practice anyway. Also, no evidence was put forward that the similar provision in the Consumer Credit Act 1974<sup>15</sup> causes problems in practice. The most compelling argument for retaining the power to enforce extra-judicially came from the Building Societies Association, who considered that present *ex parte* procedures in the county court made it too difficult to obtain an order in the absence of the mortgagor. The Association of County and District Registrars had already in their response to the Working Paper put forward suggestions for improving *ex parte* procedures, and the Building Societies Association confirmed that if such improvements could be made, their objections to insisting on a court order for enforcement of protected mortgages would be met. Our conclusion is that, subject to this last point, the arguments for making all protected mortgages enforceable on an order of the court only are overwhelming, and we recommend that in protected mortgages the power of sale should not be exercisable (and nor should any other action be taken to protect or enforce the security) except on an

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<sup>12</sup> There is considerable evidence, both anecdotal and empirical, that the sooner the parties enter into negotiations about a default, the less likely it is that the default will lead to enforcement of the security. See in particular E. Kempson, *Debt Recovery and Money Advice: a literature review prepared for the National Consumer Council* (1988) and the studies referred to there, and T. Hinton and R. Berthoud, *Money Advice Services* (1988, Policy Studies Institute).

<sup>13</sup> The same will apply to any other enforcement action sought by the mortgagee.

<sup>14</sup> Consumer Credit Act 1974, s. 126 prohibits any enforcement of a land mortgage regulated by it without a court order.

<sup>15</sup> *Ibid.*



order of the court. We are reluctant to make recommendations about court procedure at a time when the procedure in all housing actions remains under review,<sup>16</sup> but we would strongly urge that those reviewing housing action procedure should consider the need to improve *ex parte* procedures in mortgage actions.

*Exercise of power of sale after mortgagor contracts to sell*

7.16 Once a mortgagee's power of sale has arisen and become exercisable under the Law of Property Act 1925, the mortgagor is not entitled to prevent a sale by the mortgagee (unless it is in some way improper) except by tendering all money due under the mortgage.<sup>17</sup> In the present law this can cause hardship to the mortgagor if, after the mortgagor has contracted to sell the property free from the mortgage to a third party, the mortgagee proceeds to sell to someone else. Although the occasions on which this occurs in practice must be very rare, such a situation did arise in *Duke v. Robson*.<sup>18</sup> The rule will not necessarily operate unfairly (and indeed there is no evidence that it did so in the case of *Duke v. Robson*). Nevertheless, the potential for hardship is apparent. In the Working Paper we considered whether steps should be taken to ensure that such hardship could not arise under the new law. We considered the option of changing the basic rule, so that the mortgagee's power of sale would not be exercisable for so long as the mortgagor was contractually bound to sell to someone else. However we concluded that the safeguards that would have to be introduced to prevent abuse by mortgagors would unnecessarily complicate conveyancing practice.<sup>19</sup> Objections of the same kind apply to other suggestions put forward for dealing with this problem on consultation.

7.17 In our view the real problem is the mortgagor who enters into a sale contract in good faith, but then finds his mortgagee insists on selling to someone else, even though the mortgagee realises that this will put the mortgagor in breach of contract. In these strictly limited circumstances, we consider that the mortgagee ought to compensate the mortgagor for any loss suffered. We therefore recommend a solution on the lines suggested in the Working Paper.<sup>20</sup> The onus should be on the mortgagor to give the mortgagee written notice that the mortgagor has contracted to sell the mortgaged property free from the mortgage. If the mortgagee, having received such a notice, then sells the property to someone else, the mortgagee should be liable to compensate the mortgagor for any loss incurred by the mortgagor as a consequence of being put in breach of contract. It should, however, be a complete defence for the mortgagee if he can show that it was reasonable in all the circumstances for him to proceed with his sale. We can envisage a number of situations in which it would be reasonable for the mortgagee's sale to proceed even though the mortgagor is contracted to sell elsewhere. One of these would be where the mortgagor has failed to complete his sale within a reasonable period. Another would be where the proceeds of the mortgagor's sale would be insufficient to pay off the mortgagee in full, and the mortgagee is able to arrange a sale at a higher price. We recommend that both of these should be provided as specific defences, in addition to a general defence of reasonableness to cover other situations.

7.18 The considerable advantage that this solution has over other suggested solutions is that it should have only minimal effects on the practice adopted in routine sales by mortgagors and mortgagees. Prospective purchasers from mortgagors and from mortgagees need not concern themselves with the matter. It will be prudent for mortgagors to notify their mortgagees on entering into a contract for sale if there is any possibility that their mortgagee might be contemplating a sale. However, since mortgagors usually need to contact their mortgagees before completion anyway to make arrangements for the discharge of the mortgage out of the sale proceeds this should not make a great difference in practice. Mortgagees proposing to exercise their power of sale who receive written notice that their mortgagor has already contracted to sell will face the inconvenience of having to wait to see whether the mortgagor's sale proceeds to completion, but they need only wait for a reasonable period, and only if it would be unreasonable for them not to wait in the circumstances.

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<sup>16</sup> For an analysis of the current state of proposals for reform of possession proceedings see T. Goriely, "A Serious Business" (February 1990 *Legal Action* 25).

<sup>17</sup> Fisher and Lightwood *op. cit.*, pp. 391-393.

<sup>18</sup> [1973] 1 W.L.R. 267.

<sup>19</sup> See further para. 9.30 of the Working Paper, where we explained the drawbacks in this suggestion in more detail.

<sup>20</sup> *Ibid.*

7.19 In detail, our recommendation is as follows:

- (a) if the mortgagee exercises his power of sale after having received written notice from the mortgagor that the mortgagor has contracted to sell the mortgaged property free from the mortgage, the mortgagee should be liable to indemnify the mortgagor for any sum the mortgagor becomes liable to pay to a third party by reason of being unable to complete his sale contract;<sup>21</sup>
- (b) there should be no liability if the mortgagee's sale is made pursuant to a contract made before the mortgagee received written notice from the mortgagor;
- (c) there should be no liability if the mortgagee can show that it was reasonable in all the circumstances for him to sell despite having received the mortgagee's written notice;
- (d) there should be no liability if (i) the mortgagor's contract was for sale at a price insufficient to pay off the mortgagee in full, and the mortgagee sells for a higher price or (ii) the mortgagor's sale has still not been completed after a reasonable period; these defences should be without prejudice to the generality of the defence explained in (c) above.

#### *Protection of purchaser on sale by mortgagee*

7.20 By virtue of section 104(2) of the Law of Property Act 1925 a purchaser from a mortgagee selling in exercise of the statutory power of sale is concerned to see that the power of sale has arisen, but not that it has become exercisable. This must however be read subject to case law to the effect that a purchaser with notice that the power is not exercisable, or of some other irregularity, cannot rely on the section.<sup>22</sup> Although we recommend that the two stage procedure of the power arising and then becoming exercisable should be abolished, the protection we recommend a purchaser should have under the new system is essentially the same as in the present law. As a matter of general law a mortgagee can only succeed in vesting in a purchaser a title greater than the title the mortgagee itself has if it sells in exercise of a power to do so. The Law of Property Act scheme is that the mortgagee's power of sale does not come into existence until the power arises, so by necessary implication a purchaser can not get a good title from the mortgagee until then, whether or not he realises that the power has not yet come into existence. However, once the power has arisen, the purchaser *will* get a good title (because of *section* 104(2)) *unless* (as the cases confirm) the purchaser has notice of an irregularity in the sale.

7.21 We recommend that the same should apply in the new system. More specifically, in the new scheme we recommend, the power of sale will automatically come into existence on completion of the formal land mortgage but not be exercisable until one of the enforceable events we describe above occurs. Provided the purchaser has satisfied himself that there is a completed formal land mortgage, he will be assured that he will get a good title from the mortgagee unless he has notice that the power is not in fact exercisable, or that the exercise is improper for some other reason. In this context we adopt the Law of Property Act 1925 meanings of "purchaser" (meaning purchaser in good faith) and "notice" (as including constructive notice).<sup>23</sup> One practical (and, we consider, desirable) effect of this will be that in the case of a protected mortgage where the mortgagor is in occupation, the purchaser must satisfy itself either that the mortgagor consents to the sale, or that the sale is authorised by the court.

#### *Sale by mortgagee to itself*

7.22 In the present law a mortgagee exercising the statutory power of sale is not entitled to sell to itself. This is an equitable prohibition: a sale by a mortgagee to itself is not regarded as a "sale" at all.<sup>24</sup> We recommend below that the remedy of foreclosure should be abolished, and replaced by a statutory power for the mortgagee to sell to itself with leave of the court. We explain this in more detail in paragraph 7.27 below.

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<sup>21</sup> Since the abolition of the rule in *Bain v. Fothergill* by s. 4 of the Law of Property (Miscellaneous Provisions) Act 1989 (implementing the recommendations we made in our Report on the Rule in *Bain v. Fothergill*, (1987) Law Com. No. 166) there is no reason why the mortgagor should not be liable for substantial damages: for earlier doubts whether liability would have been limited by the rule see Working Paper, para. 3.63, n. 178.

<sup>22</sup> e.g. *Lord Waring v. London and Manchester Assurance Co. Ltd.* [1935] Ch. 310, 318.

<sup>23</sup> Law of Property Act 1925, s. 205(1)(xxi) and (xvii).

<sup>24</sup> See Megarry and Wade *op. cit.*, p. 940.

### *Mortgagee's duty on sale*

7.23 In the Working Paper<sup>25</sup> we considered two areas of uncertainty in the scope of the mortgagee's duty in relation to the exercise of the power of sale. The first concerns the source to which the mortgagee's duty can be ascribed: the duty has been variously described as lying in tort, and/or in equity, and/or in contract.<sup>26</sup> The second is the extent to which the duty may be limited by express provision in the mortgage deed.<sup>27</sup> Both areas are considerably complicated by the fact that the mortgagee can enforce the mortgage through the medium of a receiver appointed by the mortgagee; the receiver's liability, both to the mortgagee, and to the mortgagor and guarantor, and the mortgagee's liability for the acts of the receiver, are in turn complicated by the fact that the receiver is the agent of the mortgagor. Amidst all these complexities, the *content* of the duty is relatively straightforward: there is general acceptance that the duty can be formulated as a duty to take reasonable care to ensure that the sale price is the best price that can reasonably be obtained.<sup>28</sup> Moreover, this duty has already been enshrined by statute in relation to building societies.<sup>29</sup> We consider it will be a welcome clarification of the law if the duties of the mortgagee and the receiver can be regulated by statutory provisions applicable to all mortgages. We consider that such provisions should be overriding, and that they should enshrine the principle that the liability of a receiver for his own acts is no less extensive than that which the mortgagee who appointed him would have incurred in similar circumstances. Accordingly we recommend that the new statute should provide that, notwithstanding any agreement to the contrary,<sup>30</sup> a mortgagee and a receiver under a formal land mortgage shall be under a duty owed to the mortgagor, to any guarantors of the mortgagor, and to any subsequent mortgagees,<sup>31</sup> to take reasonable care to ensure that on a sale the price is the best price that can reasonably be obtained.

7.24 The speed with which a property is sold may affect the price realised, and it is also bound to be of concern to the mortgagor who, once the mortgagee is in possession, ceases to enjoy any benefit from the property. We are proposing that one ground on which the mortgagee should be entitled to take possession of the property should be to enable it to be sold.<sup>32</sup> The mortgagee who exercises that right must have decided to sell, so the steps of first obtaining possession and then of selling will be integrated parts of a single enforcement procedure. The mortgagee should sell as soon as is feasible after taking possession, albeit without prejudicing the price realised. We therefore recommend<sup>33</sup> that, notwithstanding any agreement to the contrary, a mortgagee who takes possession to enable the mortgaged property to be sold, should sell as soon as possible consistently with the mortgagee's duty to realise the best price reasonably obtainable.

### *Proceeds of sale*

7.25 Consultation revealed no dissatisfaction with the workings of section 105 of the Law of Property Act 1925, which provides that, after paying off prior encumbrances, the mortgagee holds the proceeds of sale on trust to be applied first in payment of the costs of sale, secondly in payment of everything due under the mortgage, and thirdly to be paid to the person next entitled (that is the subsequent encumbrancers or, if none, the mortgagor). We recommend that provision to the same effect should be included in the new statute.<sup>34</sup>

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<sup>25</sup> Paras 3.71 and 9.40.

<sup>26</sup> The liability (to both the mortgagor and the mortgagor's guarantor) was dealt with as a matter of tort in *Standard Chartered Bank Ltd. v. Walker* [1982] 1 W.L.R. 1410 (C.A.) and in *American Express International Banking Corporation v. Hurley* [1985] 3 All E.R. 564. However, *dicta* of Lord Scarman in *Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd.* [1986] A.C. 80, 107 (P.C.) suggests that the contractual relationship between mortgagee and guarantor rules out any tort relationship between them. Further, in *Parker-Tweeddale v. Dunbar Bank plc* [1991] Ch. 12, the Court of Appeal held that the mortgagee's duty on sale is a duty arising out of the mortgage relationship rather than out of a duty of care in negligence, hence it is not owed to a beneficiary under a trust of the mortgagor's interest, and in *China and South Sea Bank Ltd. v. Tan Soon Gin* [1990] 1 A.C. 536, the Privy Council held that no duty in tort was owed by a mortgagee of shares to the mortgagor's guarantor.

<sup>27</sup> See in particular *American Express v. Hurley*, *supra* at p. 571, *per* Mann J.; *Tai Hing Cotton*, *supra* at p. 110, *per* Lord Scarman; *Bishop v. Bonham* [1988] 1 W.L.R. 742; see also J.R. Lingard, *Bank Security Documents* (2nd ed., 1988), para. 11.26.

<sup>28</sup> *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd.* [1971] Ch. 949 (C.A.).

<sup>29</sup> Building Societies Act 1986, Sched. 4, para. 1.

<sup>30</sup> This will put all mortgagees in the same position as building societies are in by virtue of the Building Societies Act 1986, Sched. 4, para. 1(1)(a).

<sup>31</sup> This probably represents the present state of the law.

<sup>32</sup> Para. 7.29 below.

<sup>33</sup> Para. 7.30 below.

<sup>34</sup> Eliminating the drafting infelicity in s. 105 of the 1925 Act, which appears to require the mortgagee to give the surplus to his own purchaser.

## Foreclosure

7.26 Unlike sale, foreclosure is not a statutorily conferred right in the existing law. Essentially it is the process by which the court declares that the mortgagor's equitable right to redeem the property is extinguished. In pre-1926 legal mortgages which operated by way of conveyance (and in modern mortgages of equitable interests, which are still done by assignment) this was sufficient to make the mortgagee absolute owner of the mortgaged property. However, whilst foreclosure is an obviously appropriate remedy in relation to such property-transfer type mortgages, it is less appropriate to a mortgage by demise or charge by way of legal mortgage and, *a fortiori*, to a statutory form of mortgage such as the formal land mortgage. In such types of security, extinguishing the mortgagor's equitable right to redeem does not result in the mortgagee becoming unencumbered owner; there remains outstanding in the mortgagor a legal title which must then be transferred formally to the mortgagee.<sup>35</sup>

7.27 Foreclosure is not, then, an inevitable feature of a mortgage system, and it would be relatively unusual to import it into a statutory charge system of the type that we recommend should be adopted here.<sup>36</sup> Even in the present law it is rarely used in this country: we described it in the Working Paper as unpopular to the point of obsolescence.<sup>37</sup> In the Working Paper we explained at length the defects and complexities in the present law relating to foreclosure which have caused this unpopularity.<sup>38</sup> We concluded that, in its present state, it is unacceptably cumbersome and capable of being arbitrary in effect, and that it ought to be abolished or reformed. We put forward for consideration two different options for reform. The first was to adopt the Scottish system: this would simplify the procedure, eliminate the possibility of windfall profits, and avoid the necessity for expensive formal valuations. The second was to retain our system but introduce an element of accountability into it: in other words, the mortgagee who forecloses would be obliged to conduct a formal valuation of the property and account to the mortgagor for a sum equal to its value. Neither of these options was greeted with any enthusiasm on consultation. Instead, most respondents agreed with our preferred solution which was (and is) to abolish foreclosure outright, but give the mortgagee power, subject to satisfactory safeguards, to sell the property to himself. Accordingly we recommend that foreclosure be abolished, and that a mortgagee under a formal land mortgage should be entitled to sell to himself in exercise of the statutory power of sale, subject to the following:

- (a) the mortgagee must first obtain leave of the court; and
- (b) the court should not grant leave unless satisfied by the mortgagee that this is the most advantageous method of realising the security, from the point of view of the mortgagor, any guarantors of the mortgagor, and any subsequent encumbrancers.

## Possession

7.28 We have already explained that we consider that a mortgagee under a formal land mortgage should not have an inherent right to possession of the mortgaged property, but should, in appropriate circumstances, have a right to take possession so far as it may be necessary to enable it to protect or enforce the security.<sup>39</sup> In the succeeding paragraphs we explain what these circumstances should be, and what restrictions should be imposed on the exercise of the remedy, first in relation to possession for the purpose of sale and then in relation to possession for the purpose of protecting the security.

### *Possession for the purpose of sale*

7.29 In the case of all formal land mortgages, whether protected or non-protected, we recommend that there should be an implied overriding provision that the mortgagee should have a right to take possession of the whole or any part of the mortgaged property

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<sup>35</sup> In the case of the mortgage by demise and charge by way of legal mortgage this was done by the Law of Property Act 1925, ss. 88(2) and 89(2), and (in relation to sub-mortgages) 88(5) and 89(5). For a detailed discussion of the extent to which foreclosure is and should be available in relation to statutory mortgages and charges, see E.I. Sykes, *The Law of Securities* 4th ed. (1986), pp. 19–20, 53–54, 124–125, and 287–292.

<sup>36</sup> E.I. Sykes, *loc. cit.*

<sup>37</sup> Para. 3.45, where we describe two brief flurries of popularity it enjoyed (for jurisdictional reasons) in the 1960s and 1970s.

<sup>38</sup> Paras. 3.50–3.56.

<sup>39</sup> See para. 6.16 above.

when it is reasonably necessary to do so to enable the mortgaged property to be sold pursuant to the mortgagee's power of sale.<sup>40</sup> Our objective is that mortgagors should not be unnecessarily or prematurely deprived of possession, but that restrictions on the exercise of the right designed to achieve this should be kept to a minimum because of the importance to all concerned of a speedy, cheap and efficient enforcement system. It follows that once the mortgagee has taken possession expressly for the purpose of selling, both parties have an interest in the sale proceeding with all reasonable speed, subject only to the need to prevent undue haste jeopardising the realisation of a proper price.

7.30 In the case of non-protected mortgages, we consider that mortgagors will be sufficiently protected against a premature loss of possession by putting the mortgagee in possession under a general duty to sell as quickly as possible. There is no such duty at present,<sup>41</sup> and in some circumstances delay can prejudice the mortgagor. Nevertheless, it is appropriate that the mortgagee conducting the sale should retain the flexibility to exercise his own judgment. We recommend that an overriding provision should impose a duty on the mortgagee to sell as quickly as is consonant with his duty to take reasonable care to ensure that on sale the price is the best price that can reasonably be obtained. Since the right does not become exercisable at all until it is reasonably necessary for the mortgagee to have possession to enable it to sell, this should adequately safeguard the mortgagor (especially since the mortgagee will have duties to repair and a liability to account whilst in possession: paragraph 7.37 below).

7.31 In the case of protected mortgages, however, we consider that something more is required. This view received considerable support on consultation, particularly from consumers' organisations. The problem is that the effect of a possession order is that mortgagors are deprived of the occupation of their home without financial recompense, whilst interest continues to accrue on the total amount outstanding under the mortgage. Meanwhile, almost invariably the property will be left vacant, and consequently will deteriorate and start to fall in value. In the Working Paper we expressed the view that if this was the inevitable result of the mortgagee seeking in good faith to enforce the security in the most efficient way available, the mortgagor did not have grounds for complaint.<sup>42</sup> However, it is clear to us, both from the evidence we cited in the Working Paper,<sup>43</sup> and from views expressed to us on consultation, that many mortgagors have a sense of grievance about what happened to their property in the period between losing possession and the property being sold. Whether or not these grievances are well-founded, it would seem sensible to ensure that mortgagees are given every incentive to leave mortgagors in possession for as long as possible up to a sale, provided it can be done without unduly complicating the procedure they have to follow.

7.32 The first provision we recommend in order to achieve this follows on from our previous recommendations. We recommend that, as with sale (and for the same reasons) the mortgagee under a protected mortgage should not be entitled to take possession without first serving an enforcement notice and obtaining a court order. As we explained when considering this in the context of exercise of the power of sale, this is unlikely to make significant changes to present practice.<sup>44</sup> However, whereas under the present law a mortgagee applying for a possession order merely has to establish the existence of the mortgage, under the new scheme the mortgagee would have to satisfy the court that it had followed the enforcement notice procedure and that it was reasonably necessary for it to have possession to enable it to sell. We assume that, in practice, mortgagees would normally specify both sale and possession in their enforcement notice, and would apply to the court for possession and sale in the same application.

#### *Cesser of interest*

7.33 A further provision we recommend is intended primarily to ensure that mortgagees monitor the time passing after mortgagors have given up possession until a sale is

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<sup>40</sup> The need to express a mortgagee's right in this way is a necessary corollary of making the mortgagor entitled to possession of the mortgaged property in the absence of special circumstances: para. 6.16 above.

<sup>41</sup> *Countrywide Banking Corp. v. Robinson* [1991] 1 N.Z.L.R. 75 (C.A.), 6 C.L. 270.

<sup>42</sup> Para. 9.17.

<sup>43</sup> J. Doling, V. Karn and B. Stafford *Behind With The Mortgage—Lenders, Borrowers and Home Loan Debt: A Consumer View* (1985), pp. 124–126 (a report for the National Consumer Council); see also results of studies published since publication of the Working Paper, referred to in E. Kempson, *Debt Recovery and Money Advice: A Literature Review Prepared for The National Consumer Council* (1988), and J. Ford, *The Indebted Society* (1990).

<sup>44</sup> Paras 7.14–7.15 above.

completed. We recommend that in the case of protected mortgages, the court making an order for possession should have discretion to order that interest payable under the mortgage should cease to accrue a specified number of weeks after the execution of the order for possession. Similar provisions should apply if the mortgagor leaves voluntarily in response to a demand for possession from the mortgagee, and in both cases the mortgagee should be free to apply to the court for an extension of time at any stage. This was one of a number of suggestions we put forward in the Working Paper for ensuring that the period between possession and sale is kept to a workable minimum.<sup>45</sup> Responses to these suggestions were mixed. Consumers' organisations supported the idea of providing a further incentive for mortgagees to leave mortgagors in possession for as long as possible. Most lenders, on the other hand, felt they needed no further incentive and would have preferred the matter left in their discretion. They also pointed out that delays in sale are often caused by factors outside their control (such as a fall in the market, or a break in a chain of transactions). Our view is that there are two main advantages in dealing with the matter by making interest cease on a future target date. The first is that it provides a clearly defined sanction/incentive in respect of the duty to sell quickly: without it, a mortgagor would be unable to obtain any financial recompense for a breach of the duty without embarking on litigation,<sup>46</sup> or at the least an expensive assessment of the loss suffered as a result of the breach. The second advantage is that it gives the courts sufficient flexibility to fit the time within which sale must take place to local or special market conditions: if there are factors outside the mortgagees' control delaying the sale, it will be open to them to apply to the court for an extension of time, explaining the circumstances.

7.34 In one respect the recommendation we make here differs from the suggestion we made in the Working Paper. We suggested in the Working Paper that the period after which interest should cease to accrue should be eight weeks (or such other period as the court thinks fit) from the execution of the possession order. We are conscious that whatever period is specified, it is likely in practice to be treated as a minimum rather than a maximum, even if, as we suggested, the court has a discretion to substitute some other period for that specified. It is therefore desirable to fix a period which bears some relation to the amount of time required in practice to complete a sale in the majority of cases. Our conclusion is that the best way of achieving this is to specify a period reasonably appropriate in present conditions (which we consider to be twelve rather than eight weeks after execution of the possession order) and to give the Secretary of State power to change the period by order, if it becomes unacceptably long or short as a result of significant changes in market conditions or conveyancing practice.

7.35 The precise details of the cesser of interest scheme outlined in the previous paragraphs that we recommend should be adopted are as follows:

- (a) it should apply only to protected mortgages, and all the provisions comprising the scheme should be overriding;
- (b) on an application for possession made by the mortgagee, the court should have discretion to order that interest under the mortgage shall cease to accrue twelve weeks after execution of the possession order; the court should have power to substitute for the twelve week period such other period as it thinks fit: we would envisage that they would do so if satisfied by the mortgagee or mortgagor that some other period was more appropriate given local market conditions, or factors special to that property;
- (c) we recommend that time should run from *execution* of the order, to encourage mortgagees to delay execution (that is, the time at which the mortgagors must actually move out) to allow mortgagors who have nowhere else to go to remain in possession for as long as possible;
- (d) mortgagees should be free to apply to the court whilst the period is running for an extension of the period;
- (e) if the mortgagor leaves voluntarily after the mortgagee has evinced a clear intention of seeking possession, then similar provisions should apply: specifically, if after receipt of an enforcement notice stating that the mortgagee intends to seek

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<sup>45</sup> Para. 9.16. By "workable" we mean workable from the point of view of the mortgagee conducting the sale.

<sup>46</sup> It is not, however, intended to prevent mortgagors bringing such proceedings for breach of duty if they wish to do so.

possession and/or sale of the property, the mortgagor surrenders possession and gives the mortgagee written notice of having done so, then (i) interest should automatically cease to accrue under the mortgage twelve weeks after the mortgagor's notice is served on the mortgagee but (ii) the mortgagee should be entitled to apply to the court to have the time extended; the principle behind the provisions in this sub-paragraph is that, once the mortgagee has put into operation the machinery for obtaining possession and sale, the mortgagor should not be penalised for deciding to leave before the very last minute.

- (f) The Secretary of State should have power by order to vary the number of weeks specified.

#### *Possession to preserve the value of the mortgaged property*

7.36 In the Working Paper we expressed the tentative view that it was not necessary for a mortgagee to have a right to take possession for the purpose of protecting (as opposed to enforcing) the security, since the mortgagee could achieve the same effect by appointing a receiver.<sup>47</sup> On consultation, however, it became apparent that in the case of non-residential premises, mortgagees value the ability to be able to take possession instead of appointing a receiver in appropriate cases, and no good reason was put for depriving them of this ability. We therefore consider that in non-protected mortgages, the mortgagee should be entitled to take possession where necessary for the preservation of the value of the property. No such arguments were put in respect of residential premises, except to the extent they are mortgaged together with non-residential premises. Accordingly we recommend that:

- (a) in the case of non-protected mortgages, a mortgagee with a formal land mortgage should be entitled to take possession of all or part of the property when it is reasonably necessary to do so in order to preserve the value of the property; by "preserve the value of the property" we mean prevent, stem, or reverse, any fall in value; the mortgagee should not be required to obtain a court order before taking possession for this purpose;
- (b) once in possession, the mortgagee should be entitled to remain there only for so long as is, in the circumstances, reasonable given that the purpose of being there is to preserve the value of the property; once the mortgagee has ceased to be entitled to be there, he must sell the property or give up possession;
- (c) in the case of protected mortgages not including any non-residential property, the mortgagee should have no right to possession except for the purpose of sale (as to which see paragraphs 7.29 to 7.35 above);
- (d) in the case of protected mortgages that do include non-residential property, the mortgagee under a formal land mortgage should be entitled to apply to the court for possession for the purpose of preserving the value of the property, provided it has first served an enforcement notice: on such an application the court should be entitled to make an order affecting the non-residential part only, on the same grounds as if it were a non-protected mortgage, but should not be entitled to make an order affecting the residential part unless satisfied that it would not otherwise be possible to preserve the value of the mortgaged property as a whole; once in possession, the same provision as (b) above should apply;
- (e) if a mortgagee serves an enforcement notice stating that the mortgagee seeks possession for the purpose of preserving the property, the same provisions about interest ceasing to accrue should apply as would have applied if possession was being sought for the purpose of sale;<sup>48</sup> this of course applies only to protected mortgages.

#### *Liability of mortgagee in possession*

7.37 We have already recommended that mortgagees whilst in possession should be responsible for repair of the property: see paragraphs 6.14 and 6.15(e) above. A separate question is whether they should also be liable to account to the mortgagor for any benefit accruing to them as a result of having possession. Equity has always imposed on mortgagees in possession what is traditionally referred to as "a liability to account strictly on the basis of wilful default". This means that the mortgagee must account to the mortgagor not only for any rents or income actually received from the mortgaged property,

<sup>47</sup> We recommend below (paras. 7.39–7.46) that mortgagees under a formal land mortgage should have power to appoint a receiver, whether the mortgage is protected or non-protected.

<sup>48</sup> Paras. 7.33–7.35 above.

but also for what, but for his wilful neglect or default, the mortgagee might have received.<sup>49</sup> We criticised this principle at some length in the Working Paper.<sup>50</sup> The most serious objection we raised in the Working Paper to the liability was that (for the reasons we explained) it does nothing to encourage the mortgagee to keep the period of possession prior to sale as short as possible: we recommend elsewhere in this Report that this problem should be dealt with by other means,<sup>51</sup> in particular by providing that interest should cease to accrue in some circumstances if the mortgagee remains in possession after a specified period. The other criticisms of the liability we made lose their force once the mortgagee is only entitled to remain in possession for the strictly limited purposes of protecting or enforcing the security. Subject to the point we make in the following paragraph, our only recommendation is therefore that the liability should be formulated in modern, clearer terms. Accordingly, we recommend that it should be an overriding implied term of a formal land mortgage that the mortgagee is liable to account to the mortgagor for the rents and profits he received or ought reasonably to have received from the property whilst in possession of it.

7.38 During the period whilst the mortgagee is in possession of the mortgaged property, the mortgagor continues to be notionally in possession of the mortgagee's money, and liable to pay interest on it. The question arises whether the mortgagee's liability to account should be affected if interest ceases to accrue under the provisions we recommend in paragraphs 7.33 to 7.35 above. The situation is not likely to occur often in practice. The cesser of interest provisions are intended to apply only to protected mortgages, where the mortgaged property will not normally be income-producing, or capable of producing income bearing in mind the limited purposes for which a mortgagee will be entitled to remain in possession. However, it could arise where the mortgaged property includes agricultural or business premises. Whilst it is not wholly accurate to equate the mortgagee's duty to account for profits from the use of the mortgaged property with the mortgagor's duty to pay interest for the use of the mortgagee's money, it seems harsh on the mortgagee to require one to continue when the other has ceased. We therefore recommend that the mortgagee should not be liable to account in respect of a period during which interest has ceased to accrue by virtue of the provisions we recommend in paragraphs 7.33 to 7.35 above.

#### **Appointment of a Receiver**

7.39 Section 101(1)(iii) of the Law of Property Act 1925 empowers a mortgagee whose mortgage is made by deed to appoint a receiver of the income of the property. Although the receiver's statutory function is merely to receive the income of the property, modern mortgage deeds often give him extensive additional powers, including for example the power to sell the mortgaged property, grant leases of or encumbrances over it, carry out repairs and improvements, and even initiate and carry out building works. In other words, his contractual powers may be so extensive as to entitle him to take over the entire management of the mortgaged property.<sup>52</sup> Although the receiver is appointed by the mortgagee, and his function is to collect the income and exercise his other powers for the benefit of the mortgagee, the receiver is in law the agent of the mortgagor and not of the mortgagee.<sup>53</sup> The basic reason for this is convenience: the receiver is dealing with the mortgagor's property, and it is easier if he can do so as the mortgagor's agent, most notably because it defines the extent of his authority. This need not be a matter of concern for mortgagors, provided they can be assured of two matters. The first is that the liability of the receiver to the mortgagor is no less extensive than the liability that the mortgagee would have had if he had chosen to act directly rather than through the medium of a receiver. The second is that the receiver is worth suing.

7.40 The power to appoint a receiver is a useful remedy for a mortgagee. It is extensively used in practice, particularly in non-residential cases, and no significant objection in principle was made to the power by those who responded to the Working Paper provisions

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<sup>49</sup> Fisher and Lightwood *op. cit.*, pp. 368-9.

<sup>50</sup> Paras. 3.24-3.25.

<sup>51</sup> Paras. 7.33-7.35 above.

<sup>52</sup> In para. 3.49 of the Working Paper, we explain the distinction between this sort of receiver (often referred to as a Law of Property Act receiver, or a fixed charge receiver) and a debenture receiver (appointed under a floating charge: most debenture receivers are now administrative receivers under the Insolvency Act 1986, and referred to as such).

<sup>53</sup> Law of Property Act 1925, s. 109(2).



on receivership. Accordingly we recommend that in a formal land mortgage the mortgagee should have substantially the same power to appoint a receiver of the income of the mortgaged property as a mortgagee whose mortgage is made by deed has in the present law. However, there are a number of differences from the present law that ought to be considered.

7.41 The first is the question of the agency of the receiver. As we indicated in paragraph 7.39 above, we can see no objection to the receiver being the agent of the mortgagor rather than the mortgagee, as long as this does not reduce the effectiveness of the remedy the mortgagor has in the event of a breach of duty in relation to dealings with the mortgaged property. We have already recommended, in paragraph 7.23 above, that the liability of a receiver should be the same as that of a mortgagee. We also recommend, in paragraph 7.46 below, that receivers should be professionally qualified (and hence insured). Given these safeguards, we therefore recommend that a receiver appointed under a formal land mortgage should be the agent of the mortgagor;<sup>54</sup> this provision should be variable.

#### *When the power is exercisable*

7.42 In the present law the power to appoint a receiver becomes exercisable in the same circumstances as the power of sale becomes exercisable.<sup>55</sup> We recommend that substantially the same should apply in a formal land mortgage. The effect will, however, be different from the present law because the circumstances in which the power of sale becomes exercisable are different. It will mean that:

- (a) whether the mortgagor is protected or not protected, the power to appoint will not be exercisable unless one of the enforceable events described in paragraph 7.8 above is subsisting; and
- (b) if the mortgage is protected, the mortgagee will not be entitled to appoint a receiver unless it has first served an enforcement notice and obtained the leave of the court (for the reasons given in paragraphs 7.14 and 7.15 above);
- (c) in deciding whether to grant leave under (b) above, the court should be required to consider the effect the appointment would have on the occupation of the dwelling house, and if the effect would be to disturb that occupation, leave should be refused unless the court is satisfied that either (i) the object of the appointment is to enable the mortgagee to sell or (ii) the security cannot be protected properly by any other means.

The object of this last provision is to ensure that where there are dwelling houses involved, the mortgagee will only be entitled to appoint a receiver if it would have been entitled to take possession of the property. We explain the reasons for this in the following paragraph.

#### *Powers of receiver*

7.43 We explained in paragraph 7.39 that it is common practice to give receivers appointed under the Law of Property Act 1925 extensive powers additional to those conferred by statute. In the Working Paper<sup>56</sup> we invited comments on whether it would be desirable to restrict the range of additional powers that a receiver can be given. No good reasons were put forward for imposing any specific restriction. However, we take the view that a mortgagee should not be able to use the device of receivership to avoid restrictions that we have recommended should be imposed on the mortgagee's own actions. We therefore recommend that there should be no restriction on the powers that can be conferred on a receiver by the mortgage deed, subject to the following restraints:

- (a) as we have explained in the preceding paragraphs, some statutory provisions relating to receivers will be overriding: all express provisions in the mortgage deed will of course be subject to them. At present, a receiver may exercise powers delegated to him by the mortgagee under section 109(3) of the Law of Property Act 1925. The statutory restrictions we propose mirror those which apply to the mortgagee's powers when he exercises them personally;
- (b) it should be provided that provisions implied by statute into formal land mortgages as variable provisions, may not be varied so as to either exclude or restrict the liability of the receiver to the mortgagor, or confer on the receiver any powers that a mortgagee could not have.

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<sup>54</sup> The Cork Committee came to a similar conclusion about the agency of administrative receivers: *Report of the Review Committee on Insolvency Law and Practice* (1982) Cmnd. 8558, Ch. 8.

<sup>55</sup> Law of Property Act 1925, s. 101(1)(iii) and s. 109(1).

<sup>56</sup> Para. 9.18.

### *Receiver's duty to account*

7.44 The duty of a receiver to account for money received is at present laid down by statute, which prescribes an order of priority in making payments.<sup>57</sup> After making provision for settling public obligations such as taxes, for paying outgoings which have priority over the mortgage under which the receiver was appointed and for the costs of realisation and protecting the security, it ensures that the money is dealt with in a way which respects the established priority of all the mortgages affecting the property. This seems to us entirely appropriate. Our concern is to maintain the guiding principle which we have adopted, that the only function of mortgaged property should be to provide security for the performance of the mortgagor's payment obligations.<sup>58</sup> That means, in this context, that the receiver should not be placed under a duty to make payments which would have other results or confer other benefits. For this reason, we recommend that the receiver's duty to account should follow the long established order of priority and that this should be an overriding provision implied into all formal land mortgages.

7.45 Under the existing law a person entitled to the benefit of a payment which it is the receiver's duty to make may waive his right to that payment. Thus in *Yourell v. Hibernian Bank Ltd.*<sup>59</sup> the mortgagee bank was held unable to complain of payments made by the receiver by its direction and with its concurrence to its own disadvantage, which did not comply with the statutory order of priority.<sup>60</sup> This feature of the present law should continue. We see no reason why anyone entitled to benefit from a payment by a receiver should not voluntarily forgo all or part of what he would otherwise have been entitled to. It must always be open to someone, unilaterally and of his own volition, to waive entitlement to a benefit, and we consider that this should and will remain the case here, without express statutory provision. That must be contrasted, however, with agreements which seek to prejudice the rights of others who would be entitled or agreements intended to secure benefits to a mortgagee which go beyond the security which a mortgage should afford. By making the receiver's duty to account an overriding provision, and so rendering void any such agreement, our proposal goes beyond what the existing law provides, but this is consistent with the legislative format which we have adopted.

### *Qualifications of a receiver*

7.46 One of the major reforms introduced by the Insolvency Act 1986 was a requirement that no-one could act as an administrative receiver (or other insolvency practitioner) unless properly qualified, with supervisory bodies made responsible for monitoring qualifications.<sup>61</sup> Law of Property Act receivers are not insolvency practitioners for this purpose, and so are not covered by the Insolvency Act regulations. Whilst Law of Property Act receivers act in cases where the mortgagor is solvent, as well as cases where the mortgagor is insolvent, they are in a similar position to administrative receivers in that they are given extensive powers to manage and realise the mortgagor's property. Moreover, they do so as the mortgagor's agent but for the benefit of the mortgagee. In view of this we consider it anomalous that no qualifications are required for a person to act as a Law of Property Act receiver, and that they are not subject to the same supervisory regime as administrative receivers. This is particularly important because of the need to ensure that a receiver is able to meet any liability he may incur to the mortgagor in respect of an improper exercise of his powers. We therefore consider that no-one should be appointed as a receiver under a formal land mortgage unless properly qualified. The qualifications that we recommend should be imposed are essentially those already required to act as an insolvency practitioner under the Insolvency Act 1986, namely that the person is (a) a member of an approved professional body and (b) authorised by that body to act as a receiver and (c) supported by security for the proper performance of his functions. In effect this will mean that anyone who is qualified to act as an insolvency practitioner will also be qualified to act as a receiver under a formal land mortgage; in addition, members of professional bodies which are not approved for insolvency purposes but would be

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<sup>57</sup> Law of Property Act 1925, s. 109(8).

<sup>58</sup> Para. 3.3 above.

<sup>59</sup> [1918] A.C. 372.

<sup>60</sup> The precise ratio of this decision of the House of Lords is a matter of difficulty. In *Kerr on Receivers* (17th ed., 1989), p. 346, *Yourell* is cited for the proposition "The statutory provisions may be varied by agreement between the mortgagee and the mortgagor, but not by a direction given by the mortgagee alone". But only the speech of Lord Parker lends support to the possibility of a consensual variation and the majority pointed to the actions of the mortgagee as being decisive of the case.

<sup>61</sup> Insolvency Act 1986, ss. 388–392.

appropriate for land receivership (primarily those concerned with land management) will also qualify provided their professional body imposes suitable educational and disciplinary obligations on its members. Regulations should specify which professional bodies are to be approved for these purposes.

### **Powers of leasing**

7.47 In the present law, mortgagees in possession and receivers are entitled to grant and accept surrenders of certain leases of the mortgaged property.<sup>62</sup> As we explained in paragraph 6.20 above, we recommend that similar provisions should apply to mortgagees and receivers under a formal land mortgage, but with some significant differences: in essence, the exercise by the mortgagee or receiver of leasing powers should be subject to the same constraints as those we recommend in relation to the other remedies. In particular:

- (a) the power should be to grant (or accept a surrender of) a lease of all or part of the mortgaged property, on such terms and conditions as the mortgagee or receiver (as the case may be) thinks fit;
- (b) the power should be exercisable only by the mortgagee in possession or by a receiver, and they should be entitled to exercise the power only when either (i) it is reasonably necessary for the purpose of sale or to preserve the value of the mortgaged property or (ii) the mortgagor consents to the exercise or (iii) it is a statutory requirement<sup>63</sup> that the lease be granted;
- (c) as an additional requirement in the case of protected mortgages, there should be no power to grant a lease of the whole or part of any dwelling-house unless leave of the court has first been obtained; whilst it would not normally be appropriate for a mortgagee or receiver to grant a lease of the dwelling-house, circumstances could arise where it would be desirable for the court to have power to grant leave for this to be done (if, for example, it became apparent that a sale would be delayed, and the mortgagor was unable or unwilling to resume occupation).

### **Jurisdiction of the Court on Enforcement**

7.48 In the preceding paragraphs of this Part of the Report we have recommended that in a number of circumstances mortgagees and receivers under a protected formal land mortgage must apply to the court for leave before taking action to enforce or protect the security. It remains to consider what jurisdiction the court should have in dealing with such applications. In the present law, with two significant exceptions, if a mortgagee applies to the court for an order to enforce or protect the security,<sup>64</sup> the court has no jurisdiction to delay or withhold the remedy requested once the mortgagee has established that the right to take the appropriate action is available and has become exercisable. The first exception is the jurisdiction conferred by Part IV of the Administration of Justice Act 1970:<sup>65</sup> on an application by a mortgagee for possession of property that includes a dwelling house, the court may refuse or delay the order requested if it considers that the mortgagor is likely to be able to make up any arrears in payment or remedy any other defaults within a reasonable period. The second exception concerns mortgages securing regulated agreements under the Consumer Credit Act 1974: on any application to enforce such a mortgage, the court has the very much wider powers conferred by Part IX of the 1974 Act.<sup>66</sup>

7.49 In the case of non-protected mortgages, we recommend that no change should be made in the present law: this was the proposal made in the Working Paper,<sup>67</sup> and consultation revealed no disagreement with it. In the Working Paper we also suggested that a new single jurisdiction (essentially an expanded version of the Administration of Justice Act 1970 jurisdiction) should be available on all actions to protect or enforce a protected mortgage.<sup>68</sup> This suggestion was welcomed in principle by most of those who responded to the Working Paper, although there was less agreement on what powers the court should have in such circumstances.

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<sup>62</sup> Law of Property Act 1925, ss. 99(2) and 99(19).

<sup>63</sup> e.g. under the Landlord and Tenant Act 1954, s. 36.

<sup>64</sup> In most cases, the mortgagee is under no obligation to apply to the court; nevertheless there are many circumstances when it may be advisable to do so.

<sup>65</sup> As amended by the Administration of Justice Act 1973, s. 8.

<sup>66</sup> See in particular ss. 129–130 and 135–136.

<sup>67</sup> Para. 9.39.

<sup>68</sup> *Ibid.*

7.50 There was general agreement with our suggestion that the existing Administration of Justice Act jurisdiction should be extended to apply on all applications to enforce or protect the security or enforce repayment, and should apply to all protected mortgages. We also proposed in the Working Paper that the jurisdiction should be widened in two further respects. First, the court should be required to refuse the remedy requested if there is no subsisting default or threat to the security: this will now necessarily follow from the recommendations we make earlier in this Part of the Report about the circumstances in which the mortgagee's remedies are exercisable. Secondly, the court should have power to re-schedule payments. By this we mean that the court should not only have discretion as to how arrears should be paid (that is, by what instalments and payable over what period) but should also have power to alter the originally agreed payment schedule. This would involve requiring the mortgagee to accept payment of sums as they become due by reduced and/or differently-timed instalments. Such a power would be exercisable even if the mortgagor was not likely to be able to repay any arrears there may be and revert to the originally agreed payment schedule within a reasonable time. On these proposals there was considerable disagreement between those who responded to the Working Paper. They were welcomed not only by consumers' associations but also by the Association of County and District Registrars, who expressed the view that their existing powers to deal with enforcement cases were inadequate. Also, consultation confirmed our impression that payments often are rescheduled in practice: lenders are increasingly likely to agree to, or themselves suggest, rescheduled payments in appropriate cases before starting possession proceedings. One effect of giving the court jurisdiction to *impose* such an arrangement on an unwilling mortgagee might well be to encourage other lenders to adopt the same good lending practice, so reducing the number of cases brought before the court. On the other hand, we recognise the fear expressed by lenders that the court might make financially unrealistic orders that would delay enforcement past the stage when the accumulated arrears exceed the value of the security.

7.51 In the light of all these factors, our conclusion is that the jurisdiction should be extended to give the court power to require the mortgagee to accept re-scheduled payments, but it should be made clear that the court has no power to alter the total amount due under the mortgage, or the rate of interest payable, or the charging of interest on outstanding amounts.<sup>69</sup> Further, the court should not be entitled to re-schedule payments in the face of opposition from the mortgagee unless satisfied that the mortgaged property remains adequate security for the total indebtedness (including all costs and expenses payable by the mortgagor). Also, the mortgagee should remain free to re-apply for a variation of the order, or an immediate sale, if the property subsequently threatens to cease to be adequate security.

7.52 The Association of County and District Registrars also felt that their jurisdiction should be extended to allow them to consider whether terms of the mortgage should be set aside or varied (under the jurisdiction described in Part VIII below) at this stage. This would mean that they could consider such matters on any application by the mortgagee to protect or enforce the security, whether or not the question had been raised by the mortgagor. This proposal seemed generally acceptable, and we recommend it should be adopted.

7.53 In summary, our recommendations about the jurisdiction of the court in relation to protection and enforcement of protected mortgages are as follows:

- (a) there should be a new single jurisdiction applicable to all protected mortgages, replacing Part IV of the Administration of Justice Act 1970<sup>70</sup> and (in so far as it applies to land mortgages) the equivalent jurisdiction under the Consumer Credit Act 1974;
- (b) the jurisdiction should apply on any application by a mortgagee to protect or enforce the security or for repayment of sums due under the mortgage;
- (c) the court should have all the powers it presently has under the Administration of Justice Act 1970, expanded as described in (d) and (e) below;
- (d) it should have additional power to re-schedule payments due under the mortgage in the sense we describe in paragraph 7.50 above (but not to alter the total amount

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<sup>69</sup> Although it would have power to do all these things under the general jurisdiction to set aside or vary mortgage terms described in Part VIII below.

<sup>70</sup> As amended by Administration of Justice Act 1973, s. 8.

payable under the mortgage) if it considers it reasonable to do so, having regard to all the circumstances; the power should however not be exercisable without the mortgagee's consent unless the court is satisfied that the mortgaged property remains adequate security for the total amount that is and will become due under the mortgage; if a re-scheduling order is made, the mortgagee should be free to re-apply if the mortgaged property subsequently threatens to become inadequate security;

- (e) the court should have power to make a re-scheduling order even if it does not consider that the mortgagor will be able to make up arrears and revert to the originally agreed payment schedule within a reasonable period;
- (f) on an application by the mortgagee to protect or enforce the security or for payment of sums due under the mortgage, the court should have the powers to set aside or vary terms of the mortgage described in Part VIII of this Report.

### **Protection of Tenants of the Mortgagor**

7.54 There is one final matter relating to enforcement of the security that can conveniently be dealt with here. In Part VI of this Report we referred on several occasions to the problem of the tenant of a mortgagor who is faced with eviction because the mortgagor has defaulted in repayments under the mortgage.<sup>71</sup> This can not apply to a tenant whose tenancy was granted before the mortgage, or granted after it but with the mortgagee's consent. Such a tenancy is binding on the mortgagee, and a tenant with such a tenancy need not be concerned about defaults of the mortgagor: there can be no question of the mortgagee or (assuming the tenant is in occupation) any purchaser from the mortgagee being entitled to evict the tenant.<sup>72</sup>

7.55 The problem arises with tenancies which are not binding on the mortgagee. In the case of such a tenancy, the mortgagee is free either to evict the tenant or to sell the property to a purchaser free from the tenancy. In practice, mortgagors frequently grant tenancies not binding on the mortgagee, particularly in the case of residential property, and in many cases the tenant will not be aware that there is a mortgage and that their occupation is at risk. The practice is likely to increase rather than decrease on implementation of our recommendations.

7.56 On consultation we were strongly urged by consumers' organisations to provide some protection for tenants in such a position. In particular, it was suggested that, if the tenant can meet the payments due under the mortgage, then on an application by the mortgagee to enforce the security, the court should have discretion either to postpone enforcement for so long as the payments are made, or to order the transfer of the mortgagor's interest to the tenant.

7.57 Whilst we appreciate the concern for tenants in this position, we have reservations about both options suggested. By being required to accept payment direct from the tenant, the mortgagee is in effect being required to accept the mortgagor's tenant either as his own tenant or as mortgagor in place of the original mortgagor. If the mortgagee is being required to accept him as tenant, it is not immediately obvious what the terms of the tenancy should be, nor how such a tenancy should be treated under rent regulation and security of tenure legislation. If the mortgagor's tenant is to be treated as mortgagor in place of the original mortgagor, then presumably it will be necessary for the original mortgagor's title to be transferred to the tenant, which will not necessarily lead to a just result as between the original mortgagor and the tenant. Also, it must be remembered that payments due under the mortgage are likely to include not only payments in respect of interest, but also repayments of capital, or even payments to a third party of endowment policy premiums. This gives rise to considerable difficulties, whether payments the mortgagee receives from the mortgagor's tenant are paid in capacity of tenant or in the capacity of mortgagor: should the mortgagee be entitled (or perhaps required?) to put payments received from the new tenant/mortgagor towards the discharge of debts owed by the original mortgagor in respect of capital repayments or endowment policy premiums? If so, precisely what rights and liabilities should this give the new tenant/mortgagor as against the original mortgagor and the insurance company?

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<sup>71</sup> See paras. 6.18–6.20 above.

<sup>72</sup> The tenant's protection against a purchaser from the mortgagee would normally be ensured if the tenant is in occupation, through the doctrine of notice in unregistered land, and because the tenancy would be an overriding interest in registered land.

7.58 The problems outlined in the previous paragraph are not insoluble.<sup>73</sup> However, there is an additional problem which we consider to be fundamental. We recommend above that mortgagors should be given the right to grant whatever tenancies they think fit during the mortgage, without any reference to the mortgagee. We consider that this is an important right for mortgagors to have, and that it is justifiable on the basis that it is no concern of a mortgagee what the mortgagor chooses to do with the mortgaged property if there is no threat to the security. It is also of some benefit to tenants, in that the very existence of tenancy will no longer entitle the mortgagee to enforce the security and evict the tenant, as it does in the present law.<sup>74</sup> However, we think it must follow that mortgagees should have the power to enforce the security free from tenancies granted after the mortgage and without their consent, if it becomes necessary to do so.

7.59 Our conclusion is that it is not feasible to give the mortgagor's tenant any right to prevent or delay enforcement of the security, even if the tenant is able to pay the instalments due under the mortgage. We consider that the best that can be done in the circumstances is to ensure that such a tenant is entitled to remain in possession for as long as possible up until the time when possession is needed for enforcement. This will be one of the effects of the recommendations we make in paragraphs 7.28 to 7.36: a mortgagee under a protected mortgage will not be entitled to take possession, and hence evict the mortgagor's tenant, until it has convinced the court that it is reasonably necessary for it to do so in order to sell. Also, we anticipate that the provisions we recommend about cesser of interest will encourage mortgagees to allow mortgagors, and their tenants, to remain in possession until a sale is imminent. Recent changes in law brought about by the Housing Act 1988 restricting security of tenure for tenants should also remove the fears of mortgagees that any short term arrangements they agree to enter into with a mortgagor's tenant will prejudice the value or enforceability of the security. These measures should go some way towards ensuring that tenants in this very difficult situation are at least given time to find alternative accommodation.

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<sup>73</sup> Although in some cases a satisfactory solution might be extremely complicated: for example, if the tenant was to take over as mortgagor, it might be necessary to give the original mortgagor rights similar to those presently enjoyed in respect of foreclosure, to prevent the tenant making a windfall profit at the expense of the original mortgagor.

<sup>74</sup> Assuming that, as is usually the case, the mortgage restricts or excludes the mortgagor's powers to grant leases under the Law of Property Act 1925, s. 99.

## PART VIII

### JURISDICTION TO SET ASIDE OR VARY TERMS OF THE MORTGAGE

#### Introduction

8.1 In this part of the Report we consider what powers the court should have to set aside or vary terms of a mortgage expressly agreed by the parties. We have already dealt with some specific matters on which we recommend the court should be entitled to intervene.<sup>1</sup> Also, we do not intend any of our recommendations to affect the court's general law powers to set aside terms or bargains on grounds such as fraud, mistake, rectification, estoppel, undue influence, or restraint of trade.

8.2 Apart from the principles referred to in the preceding paragraph there are in the present law two main sources of jurisdiction enabling the court to intervene in mortgage transactions. The first is the traditional equitable mortgagor protection jurisdiction, compendiously referred to as the principle that there must be no clog or fetter on the equity of redemption.<sup>2</sup> This applies to all mortgages. The problems with this jurisdiction are that there is some uncertainty over precisely which terms are now likely to be regarded as falling foul of the principle, and that, because it evolved over the nineteenth and early twentieth centuries in a very different commercial environment, the detailed rules are not always appropriate to modern conditions.<sup>3</sup>

8.3 The second source is the extortionate credit bargain jurisdiction conferred by sections 137 to 140 of the Consumer Credit Act 1974. It applies to all mortgages where the mortgagor is an individual, and it empowers the court to "re-open" any credit bargain which it finds "extortionate" (strictly defined to cover either bargains requiring "grossly exorbitant" payments, or bargains which "otherwise grossly contravene ordinary principles of fair dealing"). This jurisdiction is in addition to and not in substitution for the equitable jurisdiction,<sup>4</sup> but the precise relationship between the two is unclear.

#### New Statutory Jurisdiction

8.4. In the Working Paper<sup>5</sup> we put forward suggestions for modernising and rationalising these jurisdictions. Our preferred solution was to provide a single new statutory jurisdiction applicable to all mortgages, defined in terms of the justifications for restricting freedom of contract between mortgagor and mortgagee that we set out in paragraph 9.5 of the Working Paper.<sup>6</sup> In other words, the court would have a discretion to alter or vary any term that (i) resulted in the mortgagee having rights in the property substantially greater than or different from those necessary to make the property available as a security or, (ii) was unconscionable in the sense used in the equitable jurisdiction or extortionate in the sense used in the Consumer Credit Act 1974. The objective would be to clarify the law without making any substantial alteration to it. There was considerable support for this proposal on consultation, and we recommend it should be adopted.

8.5 More specifically, we recommend that the court should have power to "re-open a mortgage with a view to doing justice between the parties"<sup>7</sup> if any one (or more) of four grounds is established. These are:

- (a) that principles of fair dealing were contravened when the mortgage was granted; the concept of fair dealing has become familiar in a commercial and in a consumer context through use in recent related statutes,<sup>8</sup> and we consider that it provides clearer and more flexible guidelines on acceptable business behaviour than those provided by the equitable "unfair and unconscionable" test;

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<sup>1</sup> See above paras. 6.32–6.41 (regulation of interest rates) and 6.42–6.43 (rights to redeem and rights on redemption).

<sup>2</sup> See Megarry and Wade, *op. cit.*, p. 964 *et seq.*

<sup>3</sup> For a more detailed explanation of the problems see Working Paper, paras. 3.31–3.36.

<sup>4</sup> See *Davies v. Directloans Ltd.* [1986] 1 W.L.R. 823, 831. For fuller criticisms of both jurisdictions see Working Paper, para. 9.13.

<sup>5</sup> Paras. 9.13–9.14.

<sup>6</sup> These justifications are repeated in a different context and slightly different form in para. 3.3 above.

<sup>7</sup> A formulation borrowed from the Consumer Credit Act 1974, s. 137: we explain what it entails in para. 8.8 below.

<sup>8</sup> See, for example, Consumer Credit Act 1974, s. 138 (extortionate credit bargains), Insolvency Act 1986, ss. 244 and 343 (setting aside extortionate credit transactions entered into by an insolvent before administration, liquidation or bankruptcy) and the Copyright Patents and Designs Act 1988, ss. 29–30.

- (b) that the effect of the terms of the mortgage is that the mortgagee now has rights substantially greater than or different from those necessary to make the property adequate security for the liabilities secured by the mortgage; this is intended to cover not only terms that were inappropriate at the outset, but also those that have become so as a result of, for example, changes in market conditions or an exercise of discretion by the mortgagee;
- (c) that the mortgage requires payments to be made which are exorbitant; this coupled with (a) is intended to cover (in a clearer and simpler way) all cases presently covered by the extortionate credit bargain jurisdiction under the Consumer Credit Act 1974;
- (d) that the mortgage includes a postponement of the right to redeem, or a provision tending to impede redemption; the intention is that postponements of the right to redeem will automatically be void in protected mortgages of wholly residential property, but merely challengeable under this head in the case of non-protected mortgages and protected mortgages of mixed residential and non-residential property.<sup>9</sup>

8.6 There are two particular matters on which we consider the statute ought to give the court fairly specific guidance. The first is what happens if the offending terms were freely negotiated between the parties. Whilst we appreciate the reasons why the courts are usually reluctant to intervene in such a case, one of the objectives of the jurisdiction is to ensure that the essential nature of the mortgage transaction is observed. As a means of ensuring this without providing unmeritorious mortgagors with a windfall we recommend that the fact that the terms were freely negotiated between the parties should be immaterial for the purpose of deciding whether either of the grounds described in (b) and (d) above is satisfied, but that if, having found that either ground is satisfied and the offending term ought to be set aside or varied, the court considers that the terms were freely negotiated, it should have a discretion to order the mortgagor to compensate the mortgagee for any loss suffered as a consequence of the term being set aside or varied.

8.7 The other matter on which the statute can usefully give guidance to the court is the factors which should be taken into account. We recommend that the court should be directed to take into account (in addition to whatever else it considers relevant) such matters as prevailing interest rates, the relationship between the parties, their relative financial standing, the nature and degree of any pressure the mortgagor was under, the degree of risk, and the age, experience and capacity of the mortgagor.

8.8 We also recommend that the powers the court should have (in addition to the power described in paragraph 8.5) should be analogous to those now available under the Consumer Credit Act jurisdiction: the court should be entitled to make any change whatsoever to the terms of the mortgage, and also require the mortgagee to repay any sums paid under the mortgage by the mortgagor or any other person.<sup>10</sup> The powers should be exercisable on the application by the mortgagor or the mortgagee, including any application by the mortgagee to enforce, protect or perfect the security. Since the objective is to simplify the jurisdiction, the equitable jurisdiction to set aside a term of a land mortgage which constitutes a clog or fetter on the equity of redemption should be abolished by the statute, and the relevant provisions of the Consumer Credit Act 1974 should be amended so that they no longer apply to credit bargains secured by a land mortgage.

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<sup>9</sup> See the recommendation we make in paras. 6.42–6.43 above.

<sup>10</sup> Cf. Consumer Credit Act 1974, s. 139(2).



## PART IX

### MISCELLANEOUS MATTERS

#### Tacking of further advances

9.1 Reform of the law relating to land mortgages would provide a welcome opportunity to do something about some of the problems arising out of the statutory provisions governing tacking of further advances. Priority between successive mortgages of the same property can be affected by the doctrine of tacking, in the sense that money lent by an earlier mortgagee after the creation of a later mortgage can rank for payment ahead of loans secured by the later mortgage. The doctrine of tacking was modified by section 94 of the Law of Property Act 1925 and section 30 of the Land Registration Act 1925.<sup>1</sup> As a result, a mortgagee may tack further advances to rank in priority to later mortgages (and other encumbrances) in the following circumstances:

- (a) by agreement with the subsequent mortgagee, or
- (b) if he had no notice of the subsequent mortgage at the time of making the further advance in question, or
- (c) if his mortgage imposes an obligation on him to make the further advance in question.

9.2 In the Working Paper we explained in detail a number of problems relating to the doctrine of tacking.<sup>2</sup> We do not repeat that explanation here, because, as we pointed out in paragraph 9.42 of the Working Paper, most of them cannot be tackled without affecting questions relating to charges over personal property. This applies in particular to the fundamental policy question of whether priority for further advances ought to be halted by the creation of a subsequent charge.<sup>3</sup> However, even if the other problems cannot be tackled here, there are three relatively small changes that could be made in the statutory provisions and which would remove uncertainties in the law.

9.3 The first uncertainty is over what constitutes “notice” to a prior mortgagee of a subsequent mortgage. Section 94(2) of the Law of Property Act 1925 provides that if the prior mortgage was made expressly for securing a current account or other further advances, then registration of the later mortgage as a land charge under the Land Charges Act 1972 does not constitute notice of it. However, nothing is said about registration of the later charge in the Companies Registry. It has been argued that such registration does give a prior mortgagee constructive notice for these purposes.<sup>4</sup> This would be unfortunate, since a prior mortgagee who is making further advances will have as much difficulty searching at the Companies Registry before each advance as he would have searching in the land charges registry. It would be very easy to amend section 94(2) to make it clear that registration under Part XII of the Companies Act 1985 (as amended by Part IV of the Companies Act 1989) does not constitute notice, and we recommend that this should be done.

9.4 Secondly, it has been argued that a default by the mortgagor releases the mortgagee from any obligation to make further advances, and hence the mortgagee cannot tack advances made after default.<sup>5</sup> The difficulty here is that the mortgagee will not always know immediately (or at all) when a mortgagor is in default, so would never know for certain whether the further advances being made would have priority. Again, this could be very easily remedied, by amending section 94(1)(c) of the Law of Property Act 1925 to make it clear that it applies whenever the mortgage *originally* imposed an obligation to make further advances, even if the mortgagee has subsequently been released from its obligation to do so by a default by the mortgagor. We recommend that this should be done.

9.5 The third point concerns section 30 of the Land Registration Act 1925. Section 30(3) provides that where it is noted on the register that a charge contains an *obligation* to

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<sup>1</sup> See Land Registration Rules 1925, S.R. & O. 1925, No. 1093, r.139A, added by the Land Registration (Charges) Rules 1990, S.I. 1990, No. 2613.

<sup>2</sup> Para. 3.21.

<sup>3</sup> This is discussed, for example, in the Law Reform Commission of British Columbia, *Report on Mortgages of Land: The Priority of Further Advances* (1986) L.R.C. 85.

<sup>4</sup> The point is discussed in R. M. Goode, *Commercial Law* (1982), p. 766, n. 58.

<sup>5</sup> J. R. Lingard, *Bank Security Documents* (2nd ed., 1988), para. 8.18.

make further advances, subsequent registered charges take subject to any such further advances made: it is not made clear that subsequent charges that are not registered will also take subject to the further advances. For the sake of clarity and completeness, we recommend that this should be made clear.

#### **Land Mortgages and the Consumer Credit Act 1974**

9.6 In the preceding paragraphs of this Report we make recommendations which would have the effect of substantially re-enacting the Consumer Credit Act mortgagor protection provisions to apply to all protected mortgages. One of the reasons for doing so is to remove land mortgages from the Consumer Credit Act 1974 so far as possible. As we explained in paragraphs 3.41 to 3.43 of the Working Paper, the fact that the 1974 Act applies to some but not all residential mortgages introduces significant complications into the law of land mortgages. When this point was discussed on consultation, there was considerable support for removing land mortgages completely from the 1974 Act. However, it was strongly opposed by the Office of Fair Trading, who argued that the mortgage is merely security for a loan, and that the 1974 Act provides a comprehensive scheme which gives the borrower protection against lenders by such means as licensing lenders, prohibiting canvassing and regulating advertising, which would not be included in a land mortgages act. We recognise the force of this argument, and recommend that the Consumer Credit Act 1974 should continue to apply to land mortgages in so far as it regulates the carrying on of mortgage lending business, but no longer apply in so far as it regulates the form and content of mortgages and their enforcement. Specifically, this means that the following provisions of the 1974 Act will no longer apply to land mortgages:

- (a) Part V: entry into credit agreements, which deals with preliminary matters such as disclosure of information and opportunity to withdraw from the transaction (of very limited application to land mortgages: section 58(2)), and with requirements about the form and content of mortgages and the provision of copies;
- (b) sections 76 to 78: duty to give notice before taking certain enforcement action, and to supply information to the debtor;
- (c) sections 81 and 86: appropriation of payments and effect of death of debtor;
- (d) sections 87 to 89: default notice procedure;
- (e) section 93: interest not to be increased on default;
- (f) sections 94 to 96: right to repay ahead of time and to obtain a rebate on early settlement;
- (g) section 103: termination statements;
- (h) sections 105, 112 and 113: form and content of securities and their realisation, and anti-avoidance provision (these sections will continue to apply to guarantee documents not constituting land mortgages);
- (i) section 126: enforcement of land mortgages;
- (j) Part IX: judicial control, including the extortionate credit bargain provisions.

All other provisions of the 1974 Act, including Part II (which deals with the licensing of credit businesses) and Part IV (which provides for the regulation of advertising, canvassing and quotations) will continue to apply to land mortgages in so far as they do at present.

#### **Transitional Provisions**

9.7 Necessarily, there will be a large number of mortgages already in being when the new Bill takes effect. They are not likely to comply, or to comply fully, with our proposals as to the obligations which mortgages should contain. We do not suggest that the terms of those mortgages should be varied to make them comply with the new provisions, because that would be an unacceptable, retrospective variation of the parties' bargain. Accordingly, unless it became necessary for the mortgagee to take enforcement action, the introduction of the new provisions would not affect the parties to subsisting mortgages.

9.8 By contrast, our suggested rules governing the actions of mortgagees protecting and enforcing their security can appropriately be introduced immediately, to affect existing mortgages as well as new ones. Statute has for a long time regulated the exercise of a mortgagee's powers, and our proposals modernise the provisions so that they are appropriate to today's circumstances. The principles on which they are based apply to all current mortgages, and are not affected by the date they were created. Accordingly, we

recommend that the Bill's provisions relating to the protection and enforcement of the security should apply to all mortgages subsisting on the commencement date.

9.9 Obviously, as the provisions of the Bill concerning the protection and enforcement of the security apply to "formal land mortgages", a designation only introduced by the Bill, it will be necessary to make clear which existing mortgages they affect. For this purpose, we recommend that the Bill be read as if provisions referring to "formal land mortgages" include references to mortgages by demise or sub-demise, charges by way of legal mortgage and equitable mortgages or charges created by deed.

9.10 The introduction of the new law will also affect floating charges and contracts entered into before the Bill's commencement date. The contracts may be of two types: first a contract to create a mortgage on the happening of a particular contingency, and secondly a contract to charge after-acquired property. In the present law an equitable mortgage or charge automatically arises when the relevant future event occurs (in other words when the contingency happens, or the property is acquired, or the floating charge crystallises, as the case may be). If the event occurs after the new provisions come into force it is therefore appropriate that the interest arising should constitute an informal land mortgage. We so recommend.

### **Statutory Charges**

9.11 We do not believe that the recommendations we make in this Report will have any effect on statutory charges, except in one respect: most statutes creating non-consensual charges describe their effect by reference to a specific type of legal or equitable mortgage or charge. We recommend that this should be dealt with by a general provision to the following effect:

- (a) statutes providing that a charge should take effect as if it were a mortgage by demise, a charge by way of legal mortgage, or a mortgage or charge made by deed, should be treated as if providing that it should take effect as if it were a formal land mortgage; and
- (b) in all other cases, the statute should be treated as if it provided that the charge should take effect as if it were an informal land mortgage.

### **Effect on the Crown**

9.12 We do not intend to alter or in any way affect the extent to which the Crown is presently bound by statutory mortgage provisions. Accordingly, we recommend that the effect of section 208 of the Law of Property Act 1925 should be reproduced in relation to the new provisions. Nevertheless, we have not carried out any consultation as to the effect of our proposals on Crown interests, and this aspect of our recommendations must be subject to any considerations raised on the consultation which is customarily undertaken at a later stage.

## PART X

### SUMMARY OF RECOMMENDATIONS

10.1 We conclude this Report with a summary of our conclusions and recommendations. Where appropriate, we identify the clauses in the draft Land Mortgages Bill (contained in Appendix A to this Report) to give effect to particular recommendations.

#### **The new mortgages**

10.2 All existing methods of consensually mortgaging or charging interests in land should be abolished and replaced by new forms of mortgage (the formal land mortgage and the informal land mortgage) the attributes of which would be expressly defined by statute, and which would be the only permissible methods of mortgaging any interest in land, whether legal or equitable. (Paragraphs 2.20 to 2.30; Clause 2)

10.3 In principle, the rights, powers, duties and obligations of mortgagor and mortgagee under a land mortgage should be such as are appropriate for making the mortgaged property security for the performance of the mortgagor's obligations. (Paragraphs 3.2 and 6.1 to 6.3)

#### *Variable and overriding provisions*

10.4 The statutory provisions defining the rights, powers, duties and obligations of the parties to a land mortgage should be categorised as either "variable" or "overriding". Variable provisions should be variable or excludable, either directly by an express term of the mortgage or indirectly by necessary implication from any express term. Overriding provisions should apply notwithstanding any provision to the contrary contained in the mortgage or in any other instrument. Any provision of a mortgage or any other instrument should be void to the extent that it (i) purports to impose a liability which has the effect of allowing the mortgagee to escape or mitigate the consequences of an overriding provision, or to be reimbursed the consequences of complying with it or (ii) has the effect of preventing or discouraging the mortgagor or any other person from enforcing or taking advantage of an overriding provision. (Paragraph 3.3; Clause 11)

#### *Requirement of good faith*

10.5 The rights, remedies and powers of a mortgagee under a land mortgage should be expressly stated to be exercisable only in good faith and for the purposes of protecting or enforcing the security. This should apply to all the mortgagee's rights, remedies and powers, whether derived from statute, contract, or elsewhere. (Paragraph 3.4; Clause 12)

#### *Creation of formal land mortgage*

10.6 A formal land mortgage should not be valid unless made by deed, whether the property mortgaged is a legal estate or an equitable interest. No particular form of words should be necessary in order for it to be a valid formal land mortgage, provided the words used demonstrate an intention to make the mortgaged property security for performance of the mortgagor's obligations. As an additional requirement where the mortgagor's title to all or part of the mortgaged property is registered at H.M. Land Registry, the mortgage should not qualify as a formal land mortgage unless it is substantively registered against that title. (Paragraphs 3.5 to 3.8; Clause 3)

#### *Informal land mortgage*

10.7 Informal mortgages should be recognised, to the extent that any purported consensual security over any interest in land that does not constitute a formal land mortgage but would, in the present law, give rise to an equitable mortgage or charge, should take effect as an informal land mortgage, provided the formal requirements for the creation of an informal land mortgage (paragraph 10.9 below) are satisfied. (Paragraphs 3.6, 3.9, and 3.10; Clause 2)

10.8 A mortgagee under an informal land mortgage should have no right to enforce the

security, nor to take any other action in relation to the mortgaged property, but should have a right to have the mortgage perfected by having a formal land mortgage granted to it. In the case of a protected mortgage (paragraph 10.16 below) the mortgagee should not be allowed to have the mortgage perfected without a court order; in all other cases a mortgagee who was able to procure perfection of the mortgage without recourse to the court (for example, by use of a power of attorney) should be entitled to do so. (Paragraphs 3.11 to 3.13 and 5.12; Clauses 6 and 36)

10.9 An informal land mortgage should not be valid unless it is made by deed or it satisfies requirements equivalent to those set out in section 2 of the Law of Property (Miscellaneous Provisions) Act 1989, that is unless it is in writing signed by or on behalf of the parties to it and incorporating (either directly, or indirectly by reference to another document) all the terms expressly agreed between the parties. (Paragraphs 3.14 to 3.17; Clause 4)

#### *All other consensual securities void*

10.10 Any purported security interest that does not constitute a formal land mortgage or an informal land mortgage should be void (in the sense that, whilst the purported mortgage remains personally liable to pay the debt or discharge the liabilities incurred, the purported mortgagee acquires no interest in the property and no right of recourse to it). This should not apply to non-consensual charges (that is, equitable charges arising by operation of law, statutory charges and liens): these are not affected by our recommendations. (Paragraph 2.6; Clause 2(2))

#### **Protection and Priority**

10.11 Where the mortgagor's title to the mortgaged property is registered at H.M. Land Registry, a formal land mortgage of that property should be substantively registrable. Unless and until registered it should take effect as an informal land mortgage. Once registered, it would constitute a registered charge for the purposes of the Land Registration Acts 1925 to 1988. As such, its priority would depend on the date of its registration. (Paragraphs 3.18 to 3.19; Schedule 1, paragraphs 9–15)

10.12 An informal land mortgage of a legal estate in registered land should be protectable by notice where the informal land mortgage is acknowledged by the registered proprietor. Otherwise, it should be protectable by caution. Protection by notice of deposit and notice of intended deposit should be abolished. The priority of informal land mortgages protected by notice or caution should, for the present, continue to be governed by the rules applicable to the priority of minor interests in the present law. (Paragraph 3.20 and 3.21)

10.13 Formal and informal land mortgages of commercial equitable interests in registered land should be protectable by entry of notice or caution, but for the present, protection and priority of trust equitable interests should continue to be governed by the rule in *Dearle v. Hall*. (Paragraphs 3.22 to 3.29; Clause 8)

10.14 In unregistered land all formal land mortgages of a legal estate or a commercial equitable interest should be registrable as Class C(i) land charges, and all informal land mortgages of a legal estate or a commercial equitable interest should be registrable as Class C(iii) land charges. Formal and informal mortgages of trust equitable interests should continue to be governed by the rule in *Dearle v. Hall*. (Paragraphs 3.30 to 3.33; Clause 7(2) and Clause 8)

10.15 Section 4(5) of the Land Charges Act 1972 should be amended to remove the possibility of insoluble priority circles arising where there are successive mortgages of the same property. (Paragraph 3.34; Clause 7(3) and (4))

#### **Protected mortgages**

10.16 There should be a class of protected mortgage consisting of all formal and informal land mortgages of any interest in land which includes a dwelling-house except those where either (a) the mortgagor is a body corporate, or (b) enforcement of the

mortgage would not affect the occupation of the dwelling-house or (c) the dwelling-house is occupied under a service tenancy. (Part IV; Clause 33)

### *Standardisation*

10.17 The front page of a protected mortgage should be in a form to be prescribed by regulations. The document should set out all the statutorily implied overriding and variable mortgage provisions (as varied, in the case of variable provisions) and also comply with regulations to be made about form and content of protected mortgages. In a protected mortgage the mortgagee should be under a duty to provide copies of the mortgage to those undertaking an obligation under it, in circumstances to be specified by regulations. The Office of Fair Trading should have responsibility for making and monitoring the effectiveness of all these regulations. Provisions of the Consumer Credit Act 1974 relating to the form and content of agreements and the provision of copies should cease to apply to land mortgages. (Paragraphs 5.1 to 5.11; Clauses 34 and 35)

10.18 Failure to comply with standardisation requirements should not affect the nature or validity of the mortgage. Instead, on an application by a mortgagee to perfect an informal land mortgage or to enforce a formal land mortgage, if the mortgagee has failed to comply with any of the standardisation requirements then the court should have power to refuse to make the order requested, or to make it subject to such conditions as it thinks fit. (Paragraph 5.12; Clause 37)

### **Rights and duties during the security**

#### *Documents of title*

10.19 It should be a variable provision of a first formal land mortgage that the mortgagee is entitled to possession of the mortgagor's documents of title (including, if title is registered, the mortgagor's land certificate). Whenever a mortgagee has a statutory or contractual right to the mortgagor's documents of title, the mortgagee should also have an overriding duty to keep them safely, and the mortgagor should have overriding rights of inspection and production and to take copies. (Paragraphs 6.4 to 6.8; Clause 13)

#### *Insurance*

10.20 Variable provisions about insurance should be implied into formal land mortgages. The mortgagor should be under a duty to insure the property, for at least such amounts against at least such risks as the mortgagee reasonably requires, to provide the mortgagee with evidence of compliance, and to notify the mortgagee of any claim on the insurance, and to do nothing to invalidate the insurance. The mortgagee should have a right to insure for itself if the mortgagor is in default of the obligation to insure, the cost of doing so to be a charge on the mortgaged property. (Paragraphs 6.9 to 6.12; Clause 14)

#### *Repair*

10.21 It should be a variable implied term of a formal land mortgage that, except while the mortgagee is in possession, the mortgagor should be under a duty to keep the premises in substantially the same state of repair as they were in at the time the mortgage was created and not to demolish or make any structural alterations to any buildings on the mortgaged property without the mortgagee's consent (such consent not to be unreasonably withheld). The mortgagor should also be under a variable duty to comply with all obligations affecting the mortgaged property enforceable by third parties, and to provide the mortgagee with evidence of compliance. The mortgagee should have rights to enter and repair on default by the mortgagor. (Paragraphs 6.13 and 6.15; Clauses 15 to 18)

10.22 It should be an overriding implied term of a formal land mortgage that when the mortgagee is in possession, the mortgagee owes the mortgagor duties of repair corresponding to those the mortgagor has whilst in possession. This should not, however, extend to matters covered by the mortgagor's duty to insure, and the mortgagee's obligation should be set by reference to the state of repair when the mortgagee took possession, not when the mortgage was granted. (Paragraph 6.14 and 6.15(e); Clause 21)

### *Possession*

10.23 During the security, the mortgagor should remain entitled to possession. The mortgagee should be entitled to take possession only in specified circumstances for the purposes of protecting or enforcing the security. (Paragraph 6.16; Clause 19)

### *Leasing*

10.24 It should be an overriding implied term of all formal land mortgages that when in possession the mortgagor is entitled to grant such leases of the property as it thinks fit, without having to obtain the mortgagee's consent. However, no lease granted by the mortgagor will be binding on the mortgagee unless granted with the mortgagee's written consent. (Paragraphs 6.17 to 6.21; Clause 28)

10.25 It should also be an overriding implied term that the mortgagee when in possession, and a receiver appointed by the mortgagee, is entitled to grant leases, but only with the mortgagor's consent, or if required by statute, or if it is reasonably necessary to do so to protect or enforce the security. As an additional requirement in the case of protected mortgages, neither the mortgagee nor a receiver should be entitled to grant a lease of any part of a dwelling-house comprised in the mortgaged property without leave of the court. (Paragraph 7.47; Clauses 28 and 43)

### *Transfer*

10.26 There should be no restrictions on the right of a mortgagee to transfer or otherwise deal with the mortgage, if the mortgage is not a protected mortgage. In the case of protected mortgages, if legislation is thought appropriate, it should provide that it is an overriding implied term of a protected mortgage that the mortgagee is not entitled to transfer the mortgage without having first obtained the written consent of the mortgagor, consent not to be unreasonably withheld. Regulations should prescribe the procedure to be followed by the mortgagee in applying for the mortgagor's consent, and the information to be supplied to the mortgagor. A transfer made without consent should be liable to be set aside by the court, or a ceiling on the rate of interest payable under the mortgage imposed. (Paragraphs 6.22 to 6.30; [Clause 47])

10.27 The mortgagor's interest in the mortgaged property should remain freely alienable, subject to any express restriction contained in the mortgage. (Paragraph 6.31)

### *Interest rates*

10.28 In all protected mortgages, a provision that purports to increase the rate of interest payable on default should be void. In all other mortgages, such a provision should be challengeable only under the general law relating to penalties or under the new general statutory jurisdiction to set aside or vary mortgage terms described in Part VIII of this Report. (Paragraphs 6.33 and 6.34; Clause 48(1))

10.29 In the case of all mortgages, the court should have jurisdiction to vary interest rates under the new general statutory jurisdiction described in Part VIII of this Report if the mortgage has become challengeable as a result of a variation of or failure to vary the rate of interest payable, even if under the mortgage the mortgagee is fully entitled to vary or not vary interest rates as it chooses. (Paragraph 6.36; Clause 51(1))

10.30 In the case of protected mortgages, the court should also be entitled to alter the interest rate payable, if satisfied by the mortgagor that the mortgagee has unreasonably varied or failed to vary the interest rate payable under the mortgage. In order to assess whether a variation or failure to vary is unreasonable, the court should be required to have particular regard to whether the difference between the rate complained of and the current market rate charged for loans made in equivalent circumstances is substantially greater than the difference between the rate originally charged and the then market rate. The Office of Fair Trading should have power to exempt specified lenders from these provisions. (Paragraphs 6.35 to 6.41; Clause 50)

### *Redemption*

10.31 The equitable right to redeem the property free from the mortgage after the contractual redemption date by paying and discharging all obligations under it should apply to formal and informal mortgages as it applies to all other mortgages and charges. (Paragraph 6.42)

10.32 In protected mortgages, any term of the mortgage which postpones the mortgagor's right to redeem should be void, unless the property includes non-residential premises. If it includes non-residential property, or the mortgage is not protected, then a postponement of the right to redeem should be challengeable only under the new general statutory jurisdiction described in Part VIII of this Report. (Paragraph 6.43(a); Clause 48(2))

10.33 In protected mortgages any term of the mortgage which requires the mortgagor to give notice of intention to redeem, or requires payment of interest in lieu of notice, should be void. (Paragraph 6.43(b); Clause 48(1))

10.34 Mortgagors under a protected mortgage whose repayments are calculated on the basis of the loan remaining outstanding for a specified period should be entitled to the appropriate rebate on earlier repayment. (Paragraph 6.43(c); Clause 49)

### *Consolidation*

10.35 In relation to all land mortgages the right to consolidate should be abolished. (Paragraph 6.44; Clause 32)

### *Discharge*

10.36 A land mortgage should be discharged by the mortgagor discharging all his obligations under it: no document should be necessary in order to complete the discharge. A standard form discharge should be provided by regulations to be made: use of the standard form should not be mandatory, but if the standard form is used it should operate as a good receipt for the money due under the mortgage, and a purchaser should be entitled to rely on it as sufficient evidence of discharge. (Paragraph 6.45; Clauses 57 and 58)

## **Enforcement of the Security**

### *Sale*

10.37 It should be a variable implied term of all formal land mortgages that the mortgagee has power to sell the mortgagor's interest in the mortgaged property, free from the mortgagee's own mortgage and from subsequent mortgages and other interests to which the mortgage has priority, but subject to all prior mortgages and interests taking priority over the mortgage. The power should not be exercisable unless a specified "enforceable event" has occurred and is still operative. This restriction on the exercise of the power of sale should be overriding and should also apply to the statutory power of sale as varied or replaced by any contractual provisions. (Paragraphs 7.5 to 7.10; Clause 22)

10.38 If the mortgage is a protected mortgage, the mortgagee should not be entitled to exercise the power of sale without leave of the court. (Paragraphs 7.14 to 7.15; Clause 39)

10.39 In addition in the case of protected mortgages, before exercising the power of sale the mortgagee should first have served on the mortgagor an enforcement notice in prescribed form specifying the enforceable event on which the mortgagee relies and the action (if any) to be taken by the mortgagor to remedy any default. The enforcement notice should also explain the consequences of default and how to obtain help and advice. Once the mortgagor has taken the action required by the notice, or the enforceable event is no longer operative for some other reason, the power of sale should not be exercisable. (Paragraphs 7.11 to 7.13; Clauses 38 and 45(5))

10.40 If the mortgagee exercises the power of sale after having been notified that the mortgagor has contracted to sell to someone else, the mortgagee should be liable to indemnify the mortgagor for any sum the mortgagor becomes liable to pay to a third party by reason of being unable to complete his sale contract. This should not apply if the



mortgagee contracted to sell before receiving notice of the mortgagor's sale contract, or if it was reasonable for the mortgagee to sell, either because the mortgagor's contract was for sale at a price insufficient to pay off the mortgagee in full, and the mortgagee was able to sell at a higher price than the mortgagor's price, or because the mortgagor's sale was not completed within a reasonable time, or because of some other reason. (Paragraphs 7.16 to 7.19; Clause 25)

10.41 A purchaser from a mortgagee purporting to sell in exercise of the power of sale should get a good title, provided there is a valid formal land mortgage and the purchaser is in good faith, unless the purchaser has notice that the power of sale is not exercisable or that the exercise is improper for some other reason. Notice should include constructive notice. (Paragraphs 7.20 and 7.21; Clauses 23 and 42)

10.42 A mortgagee under a formal land mortgage should be entitled to exercise the power of sale by selling the property to itself, provided leave of the court is first obtained. The court should not grant leave unless satisfied that sale to the mortgagee is the most advantageous method of realising the security. (Paragraphs 7.22 and 7.27; Clauses 24 and 41)

10.43 A mortgagee and a receiver appointed under a formal land mortgage should have an overriding duty (owed to the mortgagor, to any guarantors of the mortgagor, and to any subsequent mortgagees) to take reasonable care to ensure that on a sale the price is the best price that can reasonably be obtained. (Paragraph 7.23; Clause 26(1))

10.44 After paying off prior encumbrances, the mortgagee should hold the proceeds of sale on trust to be applied first in payment of the costs of sale, secondly in payment of everything due under the mortgage, and thirdly to be paid to the person next entitled (that is the subsequent encumbrancers or, if none, the mortgagor). (Paragraph 7.25; Clause 26(2) to (4))

#### *Foreclosure*

10.45 The remedy of foreclosure should be abolished. (Paragraph 7.26 and 7.27; Clause 64(4) and (5))

#### *Possession*

10.46 In all formal land mortgages there should be an implied overriding provision that the mortgagee is entitled to take possession of the mortgaged property when it is reasonably necessary to do so to enable the property to be sold pursuant to the mortgagee's power of sale. Once in possession the mortgagee should be under an overriding duty to sell as quickly as is consonant with the duty to take reasonable care to ensure that on sale the price is the best price that can reasonably be obtained. (Paragraphs 7.28 to 7.30; Clause 20)

10.47 In protected mortgages the mortgagee should not be entitled to possession without serving an enforcement notice and obtaining a court order. The court making an order for possession should have discretion to order that interest payable under the mortgage should cease to accrue twelve weeks (or such other period as the court thinks fit) after the execution of the order for possession. Similar provisions should apply if the mortgagor leaves voluntarily in response to a demand for possession from the mortgagee. In both cases the mortgagee should be free to apply to the court for an extension of time at any stage. The Secretary of State should have power by order to vary the period of twelve weeks. (Paragraphs 7.31 to 7.35; Clauses 38, 40 and 46)

10.48 In formal land mortgages which are not protected, the mortgagee should also have a right to take possession of the property when it is reasonably necessary to do so in order to preserve its value. Once in possession, the mortgagee should be entitled to remain there only for so long as is reasonable, given that the purpose of being there is to preserve the value of the property. (Paragraphs 7.36(a) and (b); Clause 20)

10.49 A mortgagee under a protected mortgage should have no right to take possession of the property for the purpose of preserving its value unless the property includes non-residential property. If non-residential property is included the mortgagee should be entitled to apply to the court for possession for this purpose: the court should be entitled to

make an order affecting the non-residential part only on the same grounds as if it were a non-protected mortgage, but should not be entitled to make an order affecting the residential part unless satisfied that it would not otherwise be possible to preserve the value of the property. The court making an order for possession for this purpose should have the same discretion to order that interest should cease to accrue as if possession was for sale, and the same should apply if the mortgagor leaves voluntarily in response to a demand for possession from the mortgagee. (Paragraph 7.36 (c), (d) and (e); Clauses 40(4), 40(5) and 46)

10.50 A mortgagee who is in possession, for whatever purpose, should have a duty to repair (paragraph 10.22 above) and a liability to account. The liability to account should not apply during a period when interest has ceased to accrue. (Paragraphs 6.14 and 7.37 to 7.38; Clauses 21, and 20(1)(b)(ii), 20(1)(c)(iii), 40(6), and 46(4))

#### *Appointment of a receiver*

10.51 It should be a variable implied term of a formal land mortgage that the mortgagee should have power to appoint a receiver of the income of the property who should be the agent of the mortgagor. (Paragraphs 7.39 to 7.41; Clauses 29 and 31(2))

10.52 The power should be exercisable only in circumstances in which the power of sale would be exercisable. In deciding whether to grant leave for the appointment of a receiver under a protected mortgage, the court should consider the effect the appointment would have on the occupation of any dwelling-house on the mortgaged property: if the effect would be to disturb that occupation, leave should be refused unless the court is satisfied that either (i) the object of the appointment is to enable the mortgagee to sell or (ii) the security cannot be protected properly by any other means. All provisions relating to the exercise of the power to appoint should be overriding. (Paragraph 7.42; Clauses 29 and 44)

10.53 Provisions defining the powers of a receiver should be variable, but not so as either to exclude or restrict the liability of the receiver to the mortgagor, or to confer on the receiver any powers that a mortgagee could not have. (Paragraph 7.43 to 7.45; Clauses 31 and 11(5))

10.54 No-one should be entitled to act as a receiver under a formal land mortgage unless satisfying requirements as to qualifications and suitability to be laid down by regulation. (Paragraph 7.46; Clause 30)

#### *Jurisdiction of the court on enforcement*

10.55 In the case of a formal land mortgage which is not protected, if a mortgagee applies to the court for an order to enforce or protect the security, the court should have no specific powers to delay or withhold the remedy requested once the mortgagee has established that the right to take the appropriate action is available and has become exercisable. (Paragraphs 7.48 and 7.49)

10.56 On an application by a mortgagee to protect or enforce a protected mortgage, or for payment of sums due under a protected mortgage, the court should have powers equivalent to those currently applicable to residential mortgages by virtue of Part IV of the Administration of Justice Act 1970 and the Consumer Credit Act 1974. In addition, it should have power to order the mortgagee to accept re-scheduled payments in some circumstances, and it should be allowed to consider whether any of the terms of the mortgage ought to be set aside or varied. It should not have power to refuse or delay an enforcement order on the ground that a tenant of the mortgagor whose tenancy is not binding on the mortgagee has offered to pay all sums due under the mortgage, nor should it have power to order that the mortgagor's interest should be transferred to such a tenant. (Paragraphs 7.48 to 7.59; Clause 45)

#### *Jurisdiction to set aside or vary terms of the mortgage*

10.57 There should be a new statutory jurisdiction for the court to set aside or vary terms of a land mortgage. The new jurisdiction should be in addition to the court's general law powers to set aside terms or bargains on grounds such as fraud, mistake, rectification, estoppel, undue influence, or restraint of trade. The equitable jurisdiction to set aside a

term of a land mortgage which constitutes a clog or fetter on the equity of redemption should be abolished in so far as it relates to land mortgages, and the extortionate credit bargain provisions of the Consumer Credit Act 1974 should be amended so that they no longer apply to credit bargains secured by a land mortgage. (Paragraphs 8.1 to 8.4 and 8.8; Clauses 51, 60 and 64)

10.58 Under the new jurisdiction the court should have power to set aside or vary any term of a mortgage with a view to doing justice between the parties if (a) principles of fair dealing were contravened when the mortgage was granted, or (b) the effect of the terms of the mortgage is that the mortgagee now has rights substantially greater than or different from those necessary to make the property adequate security for the liabilities secured by the mortgage, or (c) the mortgage requires payments to be made which are exorbitant, or (d) the mortgage includes a postponement of the right to redeem. (Paragraphs 8.4 and 8.5; Clause 51(1))

10.59 In deciding whether to exercise its powers on grounds (b) or (d) the court should discount the fact that the terms were freely negotiated between the parties, but in such circumstances should have a discretion to order the mortgagor to compensate the mortgagee. Otherwise, the powers the court should have under the new jurisdiction, and the factors it ought to take into account should be analogous to those now contained in the extortionate credit bargain provisions of the Consumer Credit Act 1974. (Paragraphs 8.6 to 8.8; Clause 51(3)–(6))

#### **Miscellaneous matters**

##### *Tacking of further advances*

10.60 Section 94 of the Law of Property Act 1925 should be amended to make it clear (a) that registration of a later mortgage under the Companies Act 1989 does not constitute notice of it to an earlier mortgagee seeking to tack advances made after the creation of the later mortgage, and (b) that a mortgagee who is under an obligation to make further advances remains entitled to rely on section 94 despite any default by the mortgagor releasing the mortgagee from the obligation. (Paragraphs 9.3 to 9.4; Clause 9)

10.61 It should be made clear in section 30 of the Land Registration Act 1925 that where it is noted on the register that a charge contains an obligation to make further advances, subsequent charges that are unregistered, as well as those that are registered, will take subject to any such further advances made. (Paragraph 9.5; Clause 10)

##### *Land mortgages and the Consumer Credit Act 1974*

10.62 The Consumer Credit Act 1974 should continue to apply to land mortgages in so far as it regulates the carrying on of mortgage lending business, but no longer apply in so far as it regulates the form and content of mortgages and their enforcement. (Paragraph 9.6; Clause 60)

##### *Transitional provisions*

10.63 Only those provisions of the new Bill relating to the protection and enforcement of a mortgagee's security should apply to mortgages in existence when the Bill comes into effect. For interpreting those provisions in relation to existing mortgages, "formal land mortgages" should be read to mean mortgages by demise or sub-demise, charges by way of legal mortgage and equitable mortgages or charges made by deed. (Paragraphs 9.7 to 9.9; Clause 65(4)–(6))

10.64 The equitable interests created by (i) a contract entered into before the Bill comes into force to create a mortgage on the happening of a future event which occurs thereafter, and (ii) a charge over after-acquired property made before the Bill comes into force which attaches to property acquired thereafter, and (iii) a floating charge made before but crystallising after the Bill comes into force, should all constitute informal land mortgages. (Paragraph 9.10; Clause 65(1)–(3))

*Effect on the Crown*

10.65 The Crown should be bound by the new scheme to the same extent as it is bound by the mortgage provisions of the Law of Property Act 1925. (Paragraph 9.12; Clause 63)

*(Signed)* PETER GIBSON, *Chairman*  
TREVOR M. ALDRIDGE  
JACK BEATSON  
RICHARD BUXTON  
BRENDA HOGGETT

MICHAEL COLLON, *Secretary*  
1 October 1991

APPENDIX A

**Draft**

**Land Mortgages Bill**

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ARRANGEMENT OF CLAUSES

PART I

MORTGAGES OF INTERESTS IN LAND

*Introductory*

Clause

1. Interpretation.

*Types of land mortgage*

2. Methods of mortgaging interests in land.
3. Formal land mortgages.
4. Informal land mortgages.
5. Charges under enactments.
6. Conversion of informal to formal land mortgage required for purpose of enforcing security.

PART II

PRIORITY

*General rules*

7. Mortgages of interests in unregistered land
8. Mortgages of trust equitable interests.

*Further advances*

9. General provisions as to priority.
10. Extension of protection under Land Registration Act 1925.

PART III

OVERRIDING AND VARIABLE PROVISIONS OF LAND  
MORTGAGES AND GENERAL REQUIREMENT OF GOOD  
FAITH

11. Overriding and variable provisions.
12. General requirement of good faith on part of mortgagee.

*Land Mortgages*

PART IV  
LAND MORTGAGE PROVISIONS - GENERAL

*Documents*

Clause

13. Rights, duties etc. in respect of documents.

*Insurance*

14. Duties relating to insurance.

*Repairs*

15. Standard repairing provision.

*Obligations*

16. Standard provision for compliance with statutory obligations.  
17. Standard provision for compliance with other obligations.  
18. Standard provisions for inspection, carrying out works and cost of works.

*Possession*

19. Mortgagor's general right to possession.  
20. Rights of mortgagee to possession and general duties when in possession.  
21. Duties of mortgagee in possession as to repair and compliance with obligations affecting premises.

*Sale*

22. Power of sale under formal land mortgage.  
23. Protection of purchaser.  
24. Sale by mortgagee to himself.  
25. Sale after mortgagor has contracted to sell.  
26. Duties as to proceeds of sale.  
27. Conveyances by mortgagees in exercise of their powers.

*Leasing etc.*

28. Leasing and surrenders of leases - general

*Receivers*

29. Appointment and removal.  
30. Qualifications.  
31. Functions.

*Prohibition of consolidation*

32. Redemption without payment of money due on other property.

*Land Mortgages*

PART V

LAND MORTGAGE PROVISIONS - ADDITIONAL RULES  
APPLYING ONLY TO PROTECTED MORTGAGES

*Introductory*

Clause

33. Protected mortgages.

*Form, contents and copies*

34. Regulations as to form and contents.  
35. Availability of copies for persons undertaking obligations.

*Enforcement - General*

36. Agreements for execution of formal land mortgages to replace informal land mortgages void.  
37. Failure to comply with regulations etc.  
38. Requirement of service of enforcement notice before application to court.

*Sale*

39. Requirement of court order for sale of dwelling-house.  
40. Requirement of court order for possession for purpose of sale and cesser of mortgagee's duty to account for rents and profits.  
41. Additional restriction on powers of mortgagee to sell to himself.  
42. Title of purchaser not impeachable.

*Leasing*

43. Requirement of court order for lease of dwelling-house.

*Receivers*

44. Requirement of court order for appointment of receiver.

*Special jurisdiction of court as to mortgagee's powers*

45. Jurisdiction of court on applications for certain orders relating to protected mortgages.

*Surrender of possession etc.*

46. Right of mortgagor to surrender/ possession and cesser of interest.

*[Restrictions on transfer*

47. Restrictions on transfer of mortgagee's interest.

## *Land Mortgages*

### *Void terms*

Clause

48. Void terms as to interest and redemption.
49. Rebate on early payment.
50. Regulation of variation or non-variation of interest rate under protected mortgage.

## PART VI

### MISCELLANEOUS

#### *Reopening mortgages and setting aside mortgage term*

51. Jurisdiction of court to reopen mortgages and set aside terms.

#### *Limit on number of mortgagees under formal land mortgage*

52. Effect of purported formal land mortgage in favour of more than four persons.

#### *Covenants for title*

53. Covenants for title on creation of formal or informal land mortgage.

#### *Relief against forfeiture*

54. Relief for mortgagees under formal and informal land mortgages.

#### *Transfers*

55. Transfers of mortgages.
56. Overreaching on transfer.

#### *Discharges etc.*

57. Discharge of land mortgage.
58. Standard form of discharge for formal land mortgages.
59. Effect of advance on joint account[j900]

## PART VII

### GENERAL AND SUPPLEMENTARY

60. Exclusion of provisions of Consumer Credit Act 1974.
61. Notices etc.
62. Regulations and orders.
63. Application to land in which there is Crown interest.
64. Consequential amendments, repeals etc.
65. Transitional provisions.
66. Commencement.



*Land Mortgages*

Clause

67. Citation and extent.

**SCHEDULES:**

Schedule 1 —Consequential amendments.

Schedule 2 —Enactments repealed.

DRAFT

OF A

# B I L L

INTITLED

An Act to amend the law relating to mortgages of interests in land.

**B**E IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

## PART I

### MORTGAGES OF INTERESTS IN LAND

#### *Introductory*

Interpretation.

1.—(1) In this Act—

“mortgage” means an agreement by which an interest in land is made security for the performance of an obligation;

“interest in land” means—

(a) a legal estate in land;

(b) an equitable interest in land; or

(c) an interest under a trust for sale of land;

“mortgaged property” means an interest in land which is for the time being subject to a mortgage;

“mortgagee” includes any person from time to time deriving title under the original mortgagee; and

“mortgagor” includes any person from time to time deriving title under the original mortgagor.

1925 c.20.

(2) Expressions which are used but not specifically defined in this Act and which are also used in the Law of Property Act 1925 have the same meanings as in that Act.

## EXPLANATORY NOTES

### **Clause 1**

Clause 1 contains definitions designed to bring all consensually created security interests in land within the new mortgage scheme (see paragraphs 1.1, 2.6 and 2.20 to 2.30 of the Report).

#### *Subsection (1)*

In subsection (1):-

"mortgage" is defined to include any security device affecting an interest in land which arises by agreement between the parties. Thus it includes all types of mortgage and charge, whether legal or equitable, except those arising by operation of law (for example statutory charges). It includes security interests granted to secure the performance of any obligation (for example, the repayment of money, or the performance of a guarantee or contingent liability), whether owed by the mortgagor or by any other person.

"interest in land" is defined to include all legal and equitable estates and interests in land, including the interest of a beneficiary under a trust for sale of land.

"mortgaged property" is defined as the interest in land which is mortgaged.

"mortgagee" and "mortgagor" are defined to include successors in title to the original mortgagor and mortgagee; "mortgagee" thus includes a sub-mortgagee.

#### *Subsection (2)*

This subsection makes all expressions which are not specifically defined bear the same meanings as in the Law of Property Act 1925.

## Land Mortgages

### Types of land mortgage

Methods of mortgaging interests in land.

2.—(1) A mortgage of an interest in land may be a formal land mortgage (created as mentioned in section 3 below) or an informal land mortgage (created as mentioned in section 4 below).

(2) An attempt by agreement to make an interest in land security for the performance of an obligation otherwise than by creating a formal land mortgage or an informal land mortgage is accordingly ineffective for that purpose.

Formal land mortgages.

3.—(1) A formal land mortgage must be created by deed.

1925 c.21

(2) If the title to an interest in land is registered under the Land Registration Act 1925, a mortgage by deed of that interest only becomes a formal land mortgage if it is registered under that Act.

1925c.20.

(3) The following paragraph shall be added at the end of section 1(2) of the Law of Property Act 1925 —

“(f) a formal land mortgage.”.

Informal land mortgages.

4. An informal land mortgage must be created either by deed or by an instrument which is not a deed but satisfies the requirements specified in section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 for a contract for the disposition of an interest in land.

1989 c.34

Charges under enactments.

5.—(1) Any enactment under which a charge on an interest in land takes effect as if it were a mortgage by demise, a charge by way of legal mortgage or a mortgage or charge made by deed is to be construed, in relation to a charge created after this Act comes into force, as providing that the charge takes effect as if it were a formal land mortgage.

(2) Any other enactment under which a charge on an interest in land takes effect is to be construed, in relation to a charge created after this Act comes into force, as providing that the charge takes effect as if it were an informal land mortgage.

Conversion of informal to formal land mortgage required for purpose of enforcing security.

6.—(1) Any agreement between the mortgagor and the mortgagee under an informal land mortgage which purports to give the mortgagee, without the execution (whether or not in pursuance of an order under this section) of a formal land mortgage to replace the informal land mortgage, a power—

- (a) to take possession of the premises or of any part of them;
- (b) to sell or concur with any other person in selling all or any part of the mortgaged property;
- (c) to grant a lease of all or any part of the premises; or
- (d) to appoint a receiver of the income of the mortgaged property or of any part of it,

is void to the extent that it so purports.

(2) Subject to subsection (3) below, the court shall make an order for the execution of a formal land mortgage to replace an informal

## EXPLANATORY NOTES

### Clause 2

This clause implements the recommendation in paragraph 2.30 of the Report that the only effective methods of mortgaging land shall be the formal land mortgage and the informal land mortgage.

#### Subsection (1)

The effect of this subsection is that any interest in land, whether legal or equitable, may be mortgaged by either a formal land mortgage or an informal land mortgage.

#### Subsection (2)

This subsection makes any attempt to mortgage an interest in land by any other method ineffective, in the sense that no security interest will thereby be created.

### Clause 3

Clause 3 deals with the formal requirements for the creation of a formal land mortgage and amends section 1 of the Law of Property Act 1925.

#### Subsection (1)

This subsection implements the recommendation in paragraph 3.5 of the Report that a formal land mortgage must be made by deed, whether the mortgaged property is legal or equitable.

#### Subsection (2)

This imposes an additional requirement where the mortgagor's title to the mortgaged property is registered under the Land Registration Act 1925: the mortgage of such an interest can not become a formal land mortgage unless and until it is registered. Formal land mortgages of registered titles are thus treated in the same way as legal mortgages of registered titles are treated in the present law, by virtue of section 106(2) of the Land Registration Act 1925 (as amended).

#### Subsection (3)

This makes a formal land mortgage a legal interest by adding a new paragraph to section 1(2) of the Law of Property Act 1925.

### Clause 4

Clause 4 deals with the formal requirements for the creation of an informal land mortgage. It implements the recommendation in paragraph 3.17 of the Report that the mortgage must either be made by deed or must satisfy the requirements of section 2 of the Law of Property (Miscellaneous Provisions) Act 1989.

### Clause 5

Clause 5 deals with the effect of the new mortgage scheme on statutory charges over interests in land. It implements the recommendation in paragraph 9.8 of the Report that those statutory charges specified to take effect as if mortgages by demise, charges by way of legal mortgage, or mortgages or charges made by deed, should instead take effect as if formal land mortgages, whereas all others should take effect as if informal land mortgages.

### Clause 6

This clause makes informal land mortgages unenforceable *per se*, implementing the recommendation in paragraph 3.11 of the Report. The combined effect of this clause and clause 36 is that a mortgagee with an informal mortgage will not be able to enforce the mortgage without first obtaining a formal mortgage to replace the informal mortgage; if the mortgage is protected (as defined in clause 33) it will not be possible for the mortgagee to obtain a formal mortgage to replace the informal mortgage without a court order; if the mortgage is not protected, the mortgagee will be entitled but not required to apply to the court for an order for the execution of a formal mortgage to replace the informal mortgage. This clause also provides that a formal mortgage replacing an informal mortgage will take the same priority as the informal mortgage.

#### Subsection (1)

Subsection (1) provides that any agreement between mortgagor and mortgagee which purports to give the mortgagee under an informal land mortgage powers to take possession, sell, grant leases or appoint a receiver is void. Consequently, the mortgagee will not be able to enforce the mortgage without procuring (whether by court order or otherwise) the execution of a formal mortgage to replace the informal mortgage.

#### Subsection (2)

This subsection provides that, except in the circumstances dealt with in subsection (3), when a mortgagee applies to the court for an order for the execution of a formal mortgage to replace an informal mortgage, the court must make the order once it is satisfied that the informal mortgage is valid and subsisting. In the case of protected mortgages, however, this subsection should be read with clause 37, which gives additional circumstances in which the court may or must refuse to make such an order. Subsection (2) also describes the effect of an order made by the court under this clause.

## Land Mortgages

land mortgage if it is satisfied on the application of the mortgagee under the informal land mortgage that that mortgage is valid and subsisting; and if it makes such an order, this Act has effect, immediately it does so, as if a formal land mortgage had already been executed.

(3) There is no duty to make an order under this section if it appears to the court that the making of such an order would be inappropriate because of its exercise on the application of the mortgagee of powers conferred on it by section 51 below.

(4) A formal land mortgage executed to replace an informal land mortgage (whether or not in pursuance of an order under this section) has the same priority as the informal land mortgage which it replaced.

### PART II

#### PRIORITY

##### *General rules*

Mortgages of interests in unregistered land

1972 c. 61.

7.—(1) The Land Charges Act 1972 shall be amended as follows.

(2) In section 2(4) (class C land charges) the following paragraphs shall be inserted after the first paragraph numbered (iv)—

“(v) a formal land mortgage other than a mortgage of an interest under a trust;

(vi) an informal land mortgage other than a mortgage of an interest under a trust;”.

(3) In section 4(5) (unregistered charges void against purchaser), for the words “completion of the purchase” there shall be substituted the words “relevant event”.

(4) The following subsection shall be inserted after that subsection—

“(5A) In subsection (5) above “relevant event” means—

(a) where the purchaser has acquired a land charge of Class B or Class C (other than an estate contract), the registration of that charge; and

(b) in any other case, the completion of the purchase.”

Mortgages of trust equitable interests.

1925 c.20.

8. Any question of priority between mortgages of interests under trusts shall be determined in accordance with the rule of law referred to in section 137(1) of the Law of Property Act 1925 (which applies to dealings with equitable interests in land the rule commonly known as the rule in *Dearle v Hall*).

##### *Further advances*

General provisions as to priority.

9.—(1) A prior mortgagee of an interest in land has a right to make further advances to rank in priority to subsequent mortgages—

(a) if an arrangement has been made to that effect with the subsequent mortgagees; or

## EXPLANATORY NOTES

### *Subsection (3)*

Subsection (3) allows the court to refuse to make an order under this clause where the making of the order would be inappropriate because the court has decided to reopen the mortgage or set aside its terms, in exercise of its powers under clause 51. It would be inappropriate for the court to make an order for the execution of a formal mortgage at the same time as exercising its powers under clause 51 if, for example, an order made under clause 51 resulted in there no longer being any sums due under the mortgage.

### *Subsection (4)*

Subsection (4) gives a formal mortgage the same priority as that enjoyed by any informal mortgage it replaces, whether or not the formal mortgage was executed pursuant to an order made under clause 6.

### **Clause 7**

Clause 7 deals with registration of the new mortgages in unregistered land by amending the Land Charges Act 1972: this, together with clause 8, implements the recommendations in paragraphs 3.30 to 3.34 of the Report.

### *Subsection (2)*

Subsection (1) amends section 2(4) of the Land Charges Act 1972 to make all formal and informal land mortgages registrable as class C land charges, except formal and informal land mortgages of an interest under a trust.

### *Subsections (3) and (4)*

These subsections implement the recommendation in paragraph 3.34 of the Report by amending section 4(5) of the 1972 Act to eliminate circular priority.

### **Clause 8**

Clause 8 makes the priority of mortgages of interests under a trust depend on the rule in *Dearle v. Hall*, rather than on registration, preserving the position in the present law.

### **Clause 9**

This clause derives from section 94 of the Law of Property Act 1925 (tacking and further advances) which is repealed by this Act. It reproduces section 94 of the 1925 Act with changes necessary to implement the recommendations in paragraphs 9.1 to 9.4 of the Report.

### *Subsections (1) and (2)*

These subsections reproduce section 94(1) of the Law of Property Act 1925, with additional wording at the end of subsection (1) making it clear that the right to tack under paragraph (c) (mortgage imposes an obligation to make further advances) continues notwithstanding a default by the mortgagor: this implements the recommendation in paragraph 9.4 of the Report.

## Land Mortgages

(b) if he had no notice (actual or constructive) of such subsequent mortgages at the time when the further advance was made by him; or

(c) whether or not he had such notice, where the mortgage imposes an obligation on him to make such further advances, and has the right under paragraph (c) above even if the obligation to make further advances has been released by a subsequent default by the mortgagor.

(2) Subsection (1) above applies whether or not the prior mortgage was made expressly for securing further advances.

(3) In relation to the making of further advances a mortgagee shall not be deemed to have notice of a mortgage merely by reason of its registration under an enactment unless it was so registered at the time when the original mortgage was created or when the last search (if any) of the relevant register was made by or on behalf of the mortgagee, whichever last happened.

(4) Subsection (3) above only applies where the prior mortgage was made expressly for securing a current account or other further advances.

(5) This section applies to a mortgage of an interest in land made before or after this Act comes into force.

1925 c.21. (6) If the title to the mortgaged property is registered under the Land Registration Act 1925, this section applies subject to section 30 of that Act.

Extension of protection under Land Registration Act 1925.

10. In section 30(3) of the Land Registration Act 1925, for the words "registered charge" there shall be substituted the words "mortgage or charge, whether or not registered,".

### PART III

#### OVERRIDING AND VARIABLE PROVISIONS OF LAND MORTGAGES AND GENERAL REQUIREMENT OF GOOD FAITH

Overriding and variable provisions.

11.—(1) Parts IV and V of this Act have effect as to—

(a) the provisions to be implied in land mortgages;

(b) the effect of those provisions; and

(c) the extent to which they can be varied or excluded,

Part IV applying whatever the description of the land and Part V having effect to impose in the case of certain mortgages where the land includes a dwelling-house, requirements additional to the general requirements imposed by Part IV.

(2) A provision directed to be implied in a land mortgage, or in a land mortgage of any specified description, and declared to be an overriding provision, has effect notwithstanding—

(a) any other provision of the mortgage;



## EXPLANATORY NOTES

### *Subsections (3) and (4)*

These subsections reproduce section 94(2) of the 1925 Act, but with changes to implement paragraph 9.3 of the Report by making it clear that registration of a later mortgage does not constitute notice of it (except in the limited circumstances stated), whatever the registry.

### *Subsection (5)*

This applies the new tacking provisions to all mortgages, whenever created.

### *Subsection (6)*

This deals with the application of the new tacking provisions to registered land.

### **Clause 10**

This clause amends section 30 of the Land Registration Act 1925 (tacking of further advances in registered land) to implement the recommendation made in paragraph 9.5 of the Report by making it clear that where there is a note on the register that a charge contains an obligation to make further advances, this affects all subsequent charges, not just registered charges.

### **Clause 11**

Clause 11 deals with the provisions to be implied in the new mortgages.

### *Subsection (1)*

This explains the scheme of the Act in relation to implied provisions: Part IV of the Act contains general provisions applicable to all land mortgages, and Part V imposes additional requirements in the case of protected mortgages (defined in clause 33).

### *Subsections (2) and (3)*

The provisions in Parts IV and V of the Act are stated to be either overriding or variable. Subsection (2) makes overriding provisions have effect notwithstanding anything to the contrary contained in the mortgage or in any other instrument or in any oral agreement. Subsection (3) makes void any provision contained in the mortgage or elsewhere which would allow mortgagor or mortgagee to escape or mitigate the consequences of an overriding provision, or pass the cost of complying with it to the other, or would discourage anyone from relying on an overriding provision. These subsections, together with subsections (4) and (5), implement the recommendations in paragraph 3.3 of the Report.

*Land Mortgages*

- (b) any provision of any other instrument; or
  - (c) any oral agreement.
- (3) If any provision of a land mortgage or of any other instrument or any oral agreement—
- (a) purports to impose a liability which—
    - (i) would or might allow the mortgagor or mortgagee to avoid or mitigate the consequences of an overriding provision; or
    - (ii) would or might give either of them the right to be reimbursed the cost of compliance with an overriding provision or to be compensated for such compliance in any other way; or
  - (b) attempts or tends to prevent or discourage the mortgagor or mortgagee or any other person from enforcing an overriding provision or from otherwise taking advantage of such a provision,

it is void to the extent that it would or might have that effect.

- (4) Subject to subsection (5) below, where this Act—
- (a) directs that a provision shall be implied in a land mortgage, or in a land mortgage of any specified description; and
  - (b) provides that it is variable and may be excluded altogether, it may be varied (so as to impose more or less stringent requirements) or excluded—
    - (i) by express provision in the deed or other instrument by which the mortgage is created; or
    - (ii) by necessary implication from any such express provision (including in particular any express covenant by either party relating to the same subject-matter).
- (5) Such a provision may not be varied—
- (a) so as to exclude or restrict the liabilities of a receiver to the mortgagor; or
  - (b) so as to confer on a receiver any powers that a mortgagee could not have.

General re-  
quirement of  
good faith on  
part of  
mortgagee.

12. A mortgagee's rights, remedies and powers are only available to him for use in good faith and to protect or enforce his security.

PART IV

LAND MORTGAGE PROVISIONS - GENERAL

*Documents*

Rights, duties  
etc. in respect of  
documents.

13.—(1) Subject to subsection (2) below, if a formal land mortgage is the first mortgage of an interest in land, it shall be an implied provision of the mortgage that the mortgagee has the same right to possession of documents relating to the mortgaged interest as if that interest had been assigned to him.

## EXPLANATORY NOTES

### *Subsections (4) and (5)*

The effect of subsection (4) is that, subject to the exceptions relating to receivers set out in subsection (5), variable provisions can be varied or excluded either directly by express term of the mortgage, or indirectly by necessary implication from any express term.

### **Clause 12**

This clause imposes a general limitation on the exercise of a mortgagee's rights remedies and powers, implementing the recommendation in paragraph 3.4 of the Report.

### **Clause 13**

This clause deals with documents of title. It implements the recommendations in paragraph 6.8 of the Report.

### *Subsections (1) and (2)*

These subsections make it a variable provision of the first formal land mortgage of an interest that the mortgagee is entitled to possession of the title documents relating to the interest.

## *Land Mortgages*

- (2) This provision is variable and may be excluded altogether.
- (3) The provisions specified in subsection (4) below shall be implied provisions—
  - (a) of a formal land mortgage; and
  - (b) of an informal land mortgage which contains an express provision conferring on the mortgagee the right to possess the documents of title relating to the mortgaged property.
- (4) The provisions mentioned in subsection (3) above are—
  - (a) that the documents of title shall be kept safely; and
  - (b) that the mortgagor shall be entitled from time to time, at reasonable times, on his request and at his own cost, and on payment of the costs and expenses of the person having them in his custody or power, to inspect and make copies or abstracts of or extracts from them, and to have them produced, or copies made of them as soon as is reasonably practicable.
- (5) These are overriding provisions.
- (6) If a land mortgage is discharged or otherwise extinguished, the mortgagee shall not be liable on account of delivering documents of title in his possession to a person unless he has notice that that person does not have the best right to them.

## *Insurance*

Duties relating  
to insurance.

- 14.—(1) Subject to subsections (2) and (3) below, the following provisions shall be implied in a formal land mortgage—
- (a) that the mortgagor shall insure the premises for such amounts and against such risks as the mortgagee reasonably requires and shall keep them so insured (but without prejudice to his power to insure them for greater amounts or against other risks if he thinks fit);
  - (b) that the mortgagor shall provide the mortgagee on request with such evidence of compliance with the requirement imposed under paragraph (a) above as the mortgagee reasonably requires;
  - (c) that the mortgagor shall notify the mortgagee of any claim on the insurance, and refrain from any act or omission which would invalidate the insurance;
  - (d) that, where the mortgagor has not insured the premises as required under paragraph (a) above, the mortgagee may insure them for such amounts and against such risks as he reasonably thinks fit and the premiums or other costs paid by him for such insurance shall be a charge on the mortgaged property, in addition to the mortgage money, and with the same priority as the money originally advanced under the mortgage, and with interest at the same rate as the interest payable from time to time on the mortgage money.
- (2) These provisions are variable and may be excluded altogether.

## EXPLANATORY NOTES

### *Subsections (3) - (5)*

These subsections make it an overriding provision of any mortgage where the mortgagee has a statutory or contractual right to possession of the title documents, that they shall be kept safely and that the mortgagor shall be entitled to have them copied and produced. These subsections are derived from section 96(1) of the Law of Property Act 1925 (regulations respecting inspection, production and delivery of documents).

### *Subsection (6)*

This subsection protects a former mortgagee who delivers the documents of title to the wrong person, unless he had notice that someone else had a better right to them. This reproduces section 96(2) of the Law of Property Act 1925 without substantive change.

### **Clause 14**

Clause 14 implements the recommendations in paragraph 6.12 of the Report about insurance. It implies into all formal land mortgages the variable provisions set out in paragraphs (a) to (d) of subsection (1). The mortgagor's duties are: to insure the mortgaged premises for sums and against risks reasonably required by the mortgagee; to provide the mortgagee with evidence of compliance; to notify the mortgagee of any claim and not to invalidate the insurance. If the mortgagor does not insure, the mortgagee may do so, adding the premiums to the sum secured. The power conferred on the mortgagee extends the powers contained in sections 101(1)(ii) and 108 of the Law of Property Act 1925.

## *Land Mortgages*

### *Repairs*

Standard repairing provision.

15.—(1) Subject to subsection (3) below, the standard repairing provision shall be implied in a formal land mortgage.

(2) The standard repairing provision is that except while the mortgagee is in possession of the premises the mortgagor—

(a) shall keep them in substantially the same state of repair as they were in at the date the mortgage was created; and

(b) shall not demolish them, or make structural alterations to them, without the mortgagee's consent, which shall not be unreasonably withheld.

(3) The provision is variable and may be excluded altogether.

### *Obligations*

Standard provision for compliance with statutory obligations.

16.—(1) Subject to subsection (3) below, the standard provision for compliance with statutory obligations affecting the premises shall be implied in a formal land mortgage.

(2) The standard provision for such compliance is that except while the mortgagee is in possession of the premises the mortgagor—

(a) shall comply with any obligation relating to the premises imposed by an Act of Parliament; and

(b) shall produce on the mortgagee's request such evidence of compliance with any such obligation as the mortgagee may reasonably require.

(3) The provision is variable and may be excluded altogether.

Standard provision for compliance with other obligations.

17.—(1) Subject to subsection (3) below the standard provision for compliance with obligations affecting the premises other than statutory obligations shall be implied in a formal land mortgage.

(2) The standard provision for such compliance is that except while the mortgagee is in possession of the premises the mortgagor—

(a) shall comply with any such obligation affecting the premises which is enforceable against him by any person through whom he derives his title or which is otherwise enforceable against him; and

(b) shall produce on the mortgagee's request such evidence of compliance with any such obligation as the mortgagee may reasonably require.

(3) The provision is variable and may be excluded altogether.

Standard provisions for inspection, carrying out works and cost of works.

18.—(1) Subject to subsection (2) below, the standard provision for inspecting the premises and carrying out works on them and the standard provision for the cost of such works shall be implied in a formal land mortgage.

(2) These provisions are variable and may be excluded altogether.

(3) The standard provision for inspection and carrying out works is that the mortgagor shall permit the mortgagee, at reasonable times and after reasonable notice—

## EXPLANATORY NOTES

### **Clause 15**

This clause, together with clauses 16 to 18 and clause 20, implements the recommendations in paragraph 6.15 of the Report about provisions relating to the repair and condition of the premises to be implied in mortgages. These clauses do not deal with the situation where the mortgagee is in possession: this is dealt with by clause 21.

Clause 15 makes it a variable provision of a formal land mortgage that, except while the mortgagee is in possession, the mortgagor shall keep the premises in repair and not demolish or make structural alterations without the consent of the mortgagee, consent not to be unreasonably withheld.

At present, a mortgagee has the right to restrain the mortgagor from damaging the property and diminishing the value of the security: (*McMahon v. North Kent Iron Works Co.* [1891] 2 Ch. 148).

### **Clause 16**

Clause 16 makes it a variable provision of a formal land mortgage that except while the mortgagee is in possession, the mortgagor shall comply with statutory obligations relating to the premises and provide evidence of compliance.

### **Clause 17**

Clause 17 makes it a variable provision of a formal land mortgage that, except while the mortgagee is in possession, the mortgagor shall comply with non-statutory obligations relating to the premises (for example, leasehold or freehold covenants affecting the property) and provide evidence of compliance.

### **Clause 18**

Clause 18 gives the mortgagee variable rights to enter the premises to view the state of repair and to carry out whatever works may be necessary to remedy any breach by the mortgagor of any of the obligations imposed by clauses 15 to 17, the cost to be a charge on the property.

## *Land Mortgages*

- (a) to enter the premises for the purpose of inspecting their state of repair; and
- (b) where the mortgagor—
  - (i) has not complied with his obligation under the mortgage to keep them in repair; or
  - (ii) has not carried out works on the premises necessary to comply with his statutory or other obligations,to enter the premises and carry out such works as are necessary to remedy the mortgagor's breach.

(4) The standard provision for the cost of works carried out to remedy a mortgagor's breach of his obligations is that the cost shall be a charge on the mortgaged property, in addition to the mortgage money, and with the same priority as the money originally advanced under the mortgage, and with interest at the same rate as the interest payable from time to time on the mortgage money.

### *Possession*

Mortgagor's  
general right to  
possession.

- 19.—(1) The mortgagor under an informal land mortgage has a right to possession of the premises.
- (2) The mortgagor under a formal land mortgage has a right to possession of the premises except as provided by section 20 below.
- (3) These are overriding provisions.

Rights of  
mortgagee to  
possession and  
general duties  
when in  
possession.

- 20.—(1) The following provisions shall be implied in a formal land mortgage—
- (a) that, subject to section 40(1) below, the mortgagee may take possession of the premises or of any part of them when it is reasonably necessary to do so—
- (i) to enable the mortgaged property to be sold; or
  - (ii) to prevent any or any further reduction in the value of the mortgaged property or to reverse any such reduction;
- (b) that, when the mortgagee has taken possession of the premises for the purpose mentioned in paragraph (a)(i) above—
- (i) he shall sell it as quickly as is consonant with his duty to obtain the best price reasonably obtainable for it; and
  - (ii) he shall be liable, subject to sections 40(6) and 46(4) below, to account to the mortgagor for rents and profits that he has received, or ought reasonably to have received, in respect of the premises, while he was in possession;
- (c) that, when the mortgagee has taken possession of the premises for the purpose mentioned in paragraph (a)(ii) above—
- (i) he shall be entitled to remain in possession only so long as is reasonable in all the circumstances for the purpose of preventing any or any further reduction in the value of the mortgaged property or to reverse any such reduction;



## EXPLANATORY NOTES

### Clause 19

Clause 19 deals with the mortgagor's overriding right to possession of the mortgaged property. This clause, together with clauses 20, 37 and 39, implements the recommendations in paragraphs 6.16 and 7.29 to 7.32 of the Report.

#### *Subsection (1)*

Subsection (1) provides that under an informal land mortgage the mortgagor has an unqualified right to possession of the premises: the mortgagee is not entitled to take possession in any circumstances, not even to protect or enforce the security. A mortgagee under an informal mortgage who wants to take possession for such purposes will first have to obtain a formal mortgage under clauses 6 and 36.

#### *Subsection (2)*

This subsection provides that in a formal land mortgage the mortgagor is entitled to possession, subject only to the power of the mortgagee to take possession under clause 20 for the purposes of protecting or enforcing the security.

#### *Subsection (3)*

Subsection (3) makes the provisions in subsections (1) and (2) overriding. The provisions contrast with the present position that the legal mortgagee is entitled to possession as soon as the mortgage is executed and even though the mortgagor is not in default (*Four-Maids Ltd. v. Dudley Marshall (Properties) Ltd.* [1957] Ch. 371).

### Clause 20

Clause 20 deals with the power of a mortgagee under a formal mortgage to take possession of the mortgaged premises. It should be read with clause 40, which imposes additional restrictions on the exercise of the power to take possession where the mortgage is protected.

#### *Subsection (1)*

Subsection (1) allows a formal land mortgagee to take possession only when it is reasonably necessary to do so in order to achieve one of the two objectives given in (i) and (ii) of paragraph (a). The mortgagee's power to take possession in these circumstances is expressly made subject to the additional requirements applicable in respect of protected mortgages by virtue of clause 40(1).

Paragraph (b) puts a mortgagee taking possession under (a)(i) (in order to sell) under duties to sell as quickly as is consonant with the duty to obtain the best price reasonably obtainable, and to account.

Paragraph (c) is designed to ensure that a mortgagee who takes possession under (a)(ii) (to preserve the value of the property) remains there only for so long as is reasonable for achieving this objective. Paragraph (c)(iii) makes a mortgagee in possession in order to preserve the value of the security liable to account. The duties to account imposed on the mortgagee in paragraphs (b) and (c) are derived from the equitable liability to account of a mortgagee in possession in the present law. It is expressly provided in paragraphs (b) and (c) that the mortgagee's liability to account is subject to clauses 40(6) and 46(4): the effect of this is that the mortgagee's liability will be suspended for so long as the mortgagor's liability to pay interest is suspended.

## *Land Mortgages*

(ii) after he has ceased to be entitled to remain in possession by virtue of sub-paragraph (i) above, he shall vacate the premises or sell the mortgaged property; and

(iii) he shall be liable, subject to sections 40(6) and 46(4) below, to account to the mortgagor for rents and profits that he has received or ought reasonably to have received in respect of the premises while he was in possession.

(2) These are overriding provisions.

(3) Any provision purporting to extend the powers of the mortgagee in relation to taking possession of the premises shall be ineffective.

Duties of mortgagee in possession as to repair and compliance with obligations affecting premises.

21.—(1) It shall be an implied provision of a formal land mortgage that the mortgagee, when in possession, owes the mortgagor duties relating to—

(a) repair of the premises other than repair of damage the cost of which is or ought to be covered by insurance which the mortgagor owed a duty to the mortgagee to effect, and

(b) compliance with obligations affecting the premises,

which correspond, except that for this purpose section 15(2)(a) above is to have effect as if for the words “mortgage was created” there were substituted the words “mortgagee took possession”, to the duties which would be owed to him by the mortgagor when in possession.

(2) This is an overriding provision.

### *Sale*

Power of sale under formal land mortgage.

22.—(1) Subject to subsection (2) below, it shall be an implied provision of a formal land mortgage that the mortgagee shall have power—

(a) to sell, or concur with any other person in selling, all or any part of the mortgaged property in such manner and on such terms and conditions as he thinks fit; and

(b) to vary any contract for sale, buy in at an auction, rescind any contract for sale, and re-sell, without being answerable for any loss occasioned thereby.

(2) This provision is variable and may be excluded altogether.

(3) Where a formal land mortgage confers a power of sale on the mortgagee (whether or not by virtue of the provision specified in subsection (1) above), it shall be an implied provision of the mortgage that the power of sale shall be exercisable only if—

(a) the mortgagor—

(i) has failed to comply with an obligation for payment under the mortgage other than an obligation for payment to which subsection (5) below applies; and

(ii) has not remedied that failure; or

(b) the mortgagor—

(i) by a failure to comply with an obligation under the mortgage, other than an obligation for payment, has substantially reduced the value or availability of the

## EXPLANATORY NOTES

### *Subsections (2) and (3)*

Subsection (2) makes these provisions overriding, and subsection (3) additionally prohibits any extension of a mortgagee's powers in relation to possession.

### **Clause 21**

Clause 21 makes it an overriding provision of all formal land mortgages that the mortgagee, when in possession, owes the same duties in relation to repair and compliance with obligations as are owed by the mortgagor when in possession. There are two qualifications to this. The first is that whereas the mortgagor's duties are fixed by reference to the condition of the premises at the date when the mortgage was created, the mortgagee's duties are fixed by reference to the condition of the premises when the mortgagee took possession. The second qualification is that the mortgagee's duties do not extend to matters which are, or ought to be, covered by the mortgagor's insurance (see clause 14).

### **Clause 22**

Clause 22 deals with the mortgagee's power of sale, implementing the recommendations made in paragraphs 7.5 to 7.10. It should be read with clauses 38 and 39 which contain additional restrictions on the exercise of the power of sale in so far as it relates to protected mortgages.

### *Subsections (1) and (2)*

These subsections make it a variable provision of a formal land mortgage that the mortgagee has power to sell the mortgaged property. Subsection (1) derives from section 101(1)(i) of the Law of Property Act 1925, which gives a virtually identical power of sale to mortgages made by deed in the present law.

### *Subsections (3) - (5)*

These subsections are designed to ensure that the mortgagee's power of sale (whether statutory or contractual) is not exercisable unless one of paragraphs (a), (b) or (c) of subsection (3) is satisfied:

Paragraph (a) is that there is a subsisting breach of a financial obligation under the mortgage: this does not cover breaches consisting of the consequential or artificial defaults described in subsection (5).

Paragraph (b) is that there has been a breach of a non-financial obligation which has created a substantial and still subsisting threat to the security.

Paragraph (c) is that some other event has occurred which has created a substantial and still subsisting threat to the ability of the mortgagor to pay, or a substantial threat to the security. This paragraph should be read with clause 45(4), which extends the power of the court to withhold or delay an order for sale in the case of a protected mortgage if the mortgagee seeks sale under this paragraph.

The provisions implied by subsection (3) are made overriding by subsection (4)

*Land Mortgages*

mortgaged property as a security or created a substantial risk that its value or availability as a security will be substantially reduced; and

(ii) has not remedied that failure; or

(c) any other event has occurred which—

(i) substantially reduces the ability of the mortgagor to fulfil any financial obligation under the mortgage, or creates a substantial risk that his ability to do so will be substantially reduced; or

(ii) substantially reduces the value or availability of the mortgaged property as a security, or creates a substantial risk that its value or availability as a security will be substantially reduced,

and the former state of affairs as to the mortgagor's ability to fulfil the obligation or as to the value or availability of the mortgaged property as a security has not been restored.

(4) This is an overriding provision.

(5) The obligations for payment to which this subsection applies are—

(a) an obligation for payment arising by virtue of a failure to comply with some other obligation under the mortgage (whether an obligation for payment or not); or

(b) an obligation to pay a sum of money before a particular date which the parties intended at the time the mortgage was created would not be fulfilled.

(6) It shall be an implied provision of a formal land mortgage that, where a power of sale is exercisable by reason of the mortgagor being adjudged a bankrupt, the power is not to be exercised only on account of the adjudication unless the court gives leave for it to be so exercised.

(7) This is an overriding provision.

(8) Subject to subsection (9) below, the following shall be implied provisions of a formal land mortgage—

(a) that the mortgagee may impose, reserve or make binding, as far as the law permits, by covenant, condition, or otherwise—

(i) on all or any part of the unsold part of the mortgaged property;

(ii) on the purchaser and or all or any part of what is sold,

any restriction or reservation with respect to building on or other user of land, or with respect to mines and minerals, or for the purpose of the more beneficial working of mines and minerals, or with respect to any other thing;

(b) that the mortgagee may sell all or any part of the mortgaged property—

(i) with or without a grant or reservation of rights of way, rights of water, easements, rights and privileges for or connected with building or other purposes in relation to

## EXPLANATORY NOTES

### *Subsections (6) and (7)*

It is to be an overriding provision of formal land mortgages that a power of sale, exercisable because the mortgagor is adjudicated bankrupt, may only be exercised by leave of the court. These subsections reproduce section 110 of the Law of Property Act 1925 in so far as it relates to exercise of the power of sale, with no substantive change.

### *Subsections (8) and (9)*

A variable provision is implied into formal land mortgages allowing a mortgagee to impose conditions, require covenants, grant easements and make exceptions and reservations when selling a mortgaged property. These subsections reproduce section 101(2) of the Law of Property Act 1925 with no substantive change.

*Land Mortgages*

all or any part of the premises remaining in mortgage or to any property sold;

(ii) with or without an exception or reservation of all or any mines and minerals and with or without a grant or reservation of powers of working, wayleaves or rights of way, rights of water and drainage and other powers, easements, rights and privileges for or connected with mining purposes in relation to all or any part of the premises remaining unsold or to any property sold; and

(iii) with or without covenants by the purchaser to expend money on the land sold.

(9) These provisions are variable and may be excluded altogether.

Protection of purchaser.

23.—(1) The title of a purchaser from a mortgagee shall not be impeachable on the ground that there was no power to sell because—

(a) no condition such as is mentioned in section 22(3) above was satisfied at the time of the sale; or

(b) the purported exercise of the power was otherwise improper or irregular.

(2) Subsection (1) above does not apply if the purchaser has notice of any such matter.

(3) A conveyance on sale by a mortgagee under a formal land mortgage shall be deemed to have been made in the exercise of the power of sale conferred by section 22 above unless a contrary intention appears.

(4) Any person prejudiced by an unauthorised, improper or irregular exercise of the power shall have his remedy in damages against the person exercising the power.

Sale by mortgagee to himself.

24.—(1) A mortgagee under a formal land mortgage may sell the premises to himself if the court gives him leave to do so.

(2) The court shall not grant leave unless the mortgagee satisfies the court that sale to him is the most advantageous method of realising the security, having regard to the interests—

(a) of the mortgagor;

(b) of any guarantors of the mortgage; and

(c) of subsequent mortgagees.

Sale after mortgagor has contracted to sell.

25.—(1) Subject to subsections (2) and (3) below, where a mortgagee under a formal land mortgage contracts to sell the whole or any part of the premises after receiving written notice from the mortgagor that the mortgagor has contracted to sell it, he shall be liable to indemnify the mortgagor for any sum which the mortgagor becomes liable to pay to a third party by reason of his failure to sell.

(2) It shall be a defence to any action brought by virtue of this section for the mortgagee to show that in all the circumstances it was reasonable for him to enter into the contract.

## EXPLANATORY NOTES

### **Clause 23**

Clause 23 deals with protection of a purchaser from a mortgagee selling in exercise of the power of sale. It implements the recommendations in paragraphs 7.17 and 7.19 of the Report.

#### *Subsections (1) and (2)*

The effect of these subsections is that a purchaser will not be affected by any irregularity in a sale purportedly made in exercise of the mortgagee's power of sale unless the purchaser has notice of the irregularity. The Law of Property Act 1925 meanings of "purchaser" and "notice" are imported by clause 1(2) and hence "purchaser" means purchaser in good faith and "notice" includes constructive notice. These subsections, together with subsection (4), derive from section 104(2) of the Law of Property Act 1925. They should be read with clause 42, which contains additional matter relating to the title of a purchaser from a mortgagee under a protected mortgage.

#### *Subsection (3)*

This subsection allows a purchaser to assume that, if the vendor is a mortgagee under a formal land mortgage, the sale is made in exercise of the statutory power of sale unless a contrary intention appears. It reproduces section 104(3) of the Law of Property Act 1925 without substantive change.

#### *Subsection (4)*

Subsection (4) makes it clear that the primary remedy of a mortgagor or other person adversely affected by an improper sale is to seek damages from the person exercising the power. It reproduces the end of section 104(2) of the Law of Property Act 1925 without substantive change.

### **Clause 24**

Clause 24 implements the recommendations in paragraphs 7.22 and 7.26 of the Report that a mortgagee exercising the power of sale should be entitled to sell to itself, provided leave of the court is obtained. This power replaces the remedy of foreclosure, which is abolished by clause 64(4). Subsection (2) sets out the matters on which the court must be satisfied before giving leave.

### **Clause 25**

This clause is designed to provide a remedy for a mortgagor who has contracted to sell the property free from the mortgage, but is then unable to complete the sale because of an intervening sale by the mortgagee in exercise of the power of sale. It implements the recommendations to change the law in paragraph 7.19 of the Report. The effect of the clause is that a mortgagee who has received written notice of the mortgagor's contract for sale will be liable to indemnify the mortgagor in respect of the mortgagor's liability in breach of contract, unless the mortgagee can establish one of the defences set out in subsections (2) and (3).

## *Land Mortgages*

(3) Without prejudice to the generality of subsection (2) above, it shall be a defence for the mortgagee to show that in all the circumstances it was reasonable for him to enter into the contract—

- (a) because the mortgagor had not completed the sale for which he had contracted within a reasonable period after serving the notice; or
- (b) because—
  - (i) the mortgagor's contract for sale was for a sum insufficient to repay in full the sum secured, and
  - (ii) the mortgagee's contract was for sale at a higher price than the price under the mortgagor's contract.

Duties as to proceeds of sale.

26.—(1) Notwithstanding any agreement to the contrary, a mortgagee or receiver under a formal land mortgage shall be under a duty—

- (a) to the mortgagor;
- (b) to any guarantors of the mortgage; and
- (c) to subsequent mortgagees,

to take reasonable care to ensure that on a sale the price is the best price that can reasonably be obtained.

(2) The mortgagee shall hold the purchase money in trust—

- (a) to be applied by him, after discharge of prior incumbrances to which the sale is not made subject, if any, or after payment into court of a sum to meet any prior incumbrance—
  - (i) 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
  - (ii) secondly, in discharge of the mortgage money, interest and costs and other money, if any, due under the mortgage; and

(b) to pay the residue to the mortgagor or, if he has notice that some other person has a better right, to that person.

(3) If he pays the residue to a subsequent mortgagee, that mortgagee shall hold it in trust to be applied by him in discharge of the mortgage money, interest and costs and other money, if any, due under the mortgage.

(4) The subsequent mortgagee shall thereafter be under duties corresponding to those imposed on a first mortgagee by subsections (2)(b) and (3) above.

(5) A sub-mortgagee under a sub-mortgage which is a formal land mortgage is under duties corresponding to those which this section imposes on a mortgagee or receiver under such a mortgage.

Conveyances by mortgagees in exercise of their powers.

27.—(1) A conveyance by a mortgagee in the exercise of his powers as a mortgagee must be by deed.

(2) A conveyance in the exercise of any such power frees the mortgaged property from all estates, interests, rights and power to which the mortgage has priority but leaves it subject to all estates,



## EXPLANATORY NOTES

### **Clause 26**

Clause 26 deals with the duties of a mortgagee or receiver selling in exercise of the power of sale. It implements the recommendations in paragraphs 7.20 and 7.21 of the Report.

#### *Subsection (1)*

Subsection (1) puts the mortgagee and receiver under a duty (derived from the present law) to take reasonable care to ensure that on a sale the price is the best price that can reasonably be obtained. It makes it clear that the duty is owed to the mortgagor (which by virtue of the definition in clause 1(1) includes those deriving title from the mortgagor), to guarantors and to subsequent mortgagees.

#### *Subsections (2) to (5)*

These subsections deal with the distribution of the proceeds of sale in accordance with the recognised order of priorities of mortgages. They reproduce section 105 of the Law of Property Act 1925 with no substantive change.

### **Clause 27**

#### *Subsection (1)*

Subsection (1) requires a sale in exercise of the power of sale to be made by deed. This applies whether the mortgaged property is legal or equitable. This requirement follows the present law in section 104(1) of the Law of Property Act 1925.

#### *Subsection (2)*

Subsection (2) (which derives from section 104(1) of the Law of Property Act 1925) explains the effect of a sale made in exercise of the mortgagee's power of sale. It makes it clear that a sale made in the exercise of the power of sale vests in the purchaser the mortgaged property freed from interests to which the mortgage has priority, but subject to the interests taking priority over the mortgage (except those overreached under section 2 of the Law of Property Act 1925).

## *Land Mortgages*

1925 c.20

interests and rights which have priority to the mortgage and which are not overreached under section 2 of the Law of Property Act 1925 .

### *Leasing etc.*

Leasing and  
surrenders of  
leases - general

28.—(1) It shall be an implied provision of a formal land mortgage that—

- (a) the mortgagor when in possession of the premises;
- (b) the mortgagee when in possession; and
- (c) a receiver,

shall each have power from time to time—

- (i) to grant a lease of all or any part of the premises on such terms and conditions as he thinks fit; and
- (ii) to accept a surrender of a lease of all or any part of them.

but that the mortgagee and a receiver shall only have power to do so in the cases specified in subsection (3) below.

(2) This is an overriding provision.

(3) The cases mentioned in subsection (1) above are—

- (a) when it is reasonably necessary for the purpose of sale or to prevent any or any further reduction in the value of the mortgaged property or reverse any such reduction;
- (b) when the mortgagor consents; and
- (c) when a lease falls to be executed under section 36 of the

1954 c.56.

Landlord and Tenant Act 1954.

(4) If the mortgagor under a formal land mortgage grants a lease of all or part of the premises without the mortgagee's written consent, the lease does not bind the mortgagee or a receiver.

### *Receivers*

Appointment  
and removal.

29.—(1) Subject to subsection (2) below, it shall be an implied provision of a formal land mortgage that the mortgagee shall have power to appoint and remove a receiver of the income of the mortgaged property.

(2) This provision is variable and may be excluded altogether.

(3) Where a formal land mortgage confers on the mortgagee power to appoint a receiver, it shall be an implied provision of the mortgage that the mortgagee may only exercise the power if he has become entitled to exercise the powers conferred on him by section 22(1)(a) above.

(4) It shall be an implied provision of a formal land mortgage that where a power to appoint a receiver is exercisable by reason of the mortgagor being adjudged a bankrupt, the power is not to be exercised only on account of the adjudication unless the court gives leave for it to be so exercised.

(5) The provisions specified in subsections (3) and (4) above are overriding provisions.

## EXPLANATORY NOTES

### **Clause 28**

Clause 28 deals with powers of leasing the mortgaged property. This clause, together with clause 43 (which imposes additional requirements in the case of leases granted by mortgagees under protected mortgages), implements the recommendations in paragraphs 6.21 and 7.47 of the Report. Clause 28 implies into formal land mortgages as overriding provisions power for the mortgagor in possession, the mortgagee in possession and a receiver to grant leases of the property. The mortgagee in possession and the receiver are given power to lease only in the limited cases set out in subsection (2). The mortgagor's power, on the other hand, is unlimited, subject only to the restriction contained in subsection (4): leases granted without the mortgagee's written consent are not binding on the mortgagee or receiver. This means that the mortgage can be enforced freed from such leases, but as a consequence of the mortgagor's power being overriding, the mortgagee will not be able to prevent or interfere with such leases except by enforcing the security (assuming the mortgagee is otherwise entitled to do so). At present both mortgagors and mortgagees have, while in possession, full statutory authority to grant leases of specified types on particular terms, but the authority is subject to any provision to the contrary in the mortgage deed (Law of Property Act 1925, section 99).

### **Clause 29**

Clause 29 deals with the mortgagee's power to appoint a receiver, implementing the recommendations in paragraphs 7.39 to 7.42 of the Report.

#### *Subsections (1) and (2)*

These subsections imply the power to appoint a receiver into all formal land mortgages as a variable provision. At present, section 101(1)(iii) of the Law of Property Act 1925 gives a mortgagee under a mortgage by deed the power to appoint a receiver when the mortgage money has become due.

#### *Subsection (3) - (5)*

These subsections, which derive from section 109(1) of the Law of Property Act 1925, make the power exercisable only when the power of sale is exercisable. The provisions implied by these subsections are overriding.

*Land Mortgages*

(6) The appointment or removal of a receiver shall be by writing under the hand of the mortgagee.

Qualifications.

30.—(1) A person is not qualified to act as a receiver unless—

(a) either—

(i) he is qualified to act as an insolvency practitioner under Part XIII of the Insolvency Act 1986; or

1986 c.45

(ii) he is authorised to act by virtue of membership of a professional body recognised under this section, being permitted so to act by or under the rules of that body; and

(b) there is in force security for the proper performance of his functions.

(2) The Secretary of State may by order declare a body which appears to him to fall within subsection (3) below to be a recognised professional body for the purposes of this section.

(3) A body may be recognised if it regulates the practice of a profession and maintains and enforces rules for securing that such of its members as are permitted by or under the rules to act as receivers under this Act—

(a) are fit and proper persons so to act; and

(b) meet acceptable requirements as to education and practical training and experience.

(4) The references to members of a recognised professional body are to persons who, whether members of that body or not, are subject to its rules in the practice of the profession in question.

The reference to membership of a professional body recognised under this section in subsection (1)(a)(ii) above is to be read accordingly.

(5) An order made under this section in relation to a professional body may be revoked by a further order if it appears to the Secretary of State that the body no longer falls within subsection (3) above.

(6) An order under this section has effect from such date as is specified in the order; and any such order revoking a previous order may make provision whereby members of the body in question continue to be treated as authorised to act as receivers for the purposes of this Act for a specified period after the revocation takes effect.

(7) The power to make an order conferred by this section is exercisable by statutory instrument subject to annulment by resolution of either House of Parliament.

Functions.

31.—(1) Subject to subsection (7) below, the provisions set out in subsections (2) to (6) below shall be implied in a formal land mortgage.

(2) A receiver shall be deemed to be the agent of the mortgagor and the mortgagor shall be solely responsible for the receiver's acts or defaults.

## EXPLANATORY NOTES

### *Subsection (6)*

This subsection requires the appointment and removal of a receiver to be made in writing by the mortgagee. A deed is not needed. The same requirement applies in the present law, by virtue of subsections (1) and (5) of section 109 of the Law of Property Act 1925.

### **Clause 30**

Clause 30 implements the recommendations in paragraph 7.46 of the Report about the qualifications of a receiver.

### *Subsection (1)*

Subsection (1) sets out the qualifications a person must have in order to be qualified to act as a receiver. The qualifications are either qualification to act as an insolvency practitioner or membership of (and authorisation to act from) a recognised professional body. In addition, in either case, security must be provided.

### *Subsections (2) - (7)*

These subsections give the Secretary of State power to specify by order the professional bodies that are recognised for these purposes. Professional bodies may not be recognised unless they satisfy the requirements set out in subsection (3). Subsection (5) allows the Secretary of State to revoke an order recognising a body which no longer falls within subsection (3).

### **Clause 31**

Clause 31, which derives from section 104 of the Law of Property Act 1925, deals with the functions of a receiver.

### *Subsection (2)*

This subsection, which reproduces section 109(2) of the Law of Property Act 1925 without substantive change, implies into formal land mortgages as a variable provision that a receiver shall be deemed to be the agent of the mortgagor (implementing the recommendation in paragraph 7.41 of the Report).

## *Land Mortgages*

(3) A receiver shall have power to demand and recover all the income of which he is appointed receiver in the name either of the mortgagor or of the mortgagee, and to give effectual receipts for it.

(4) A person paying money to a receiver shall not be concerned to inquire whether any case has happened to authorise the receiver to act.

(5) A 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 5 per cent. 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 5 per cent. on that gross amount, or at such other rate as the court thinks fit to allow, on application made by him for that purpose.

(6) A receiver, if so directed in writing by the mortgagee, shall insure to the extent, if any, to which the mortgagee might have insured under the mortgage.

(7) The provisions set out in subsections (2) to (6) above are variable and may be excluded altogether.

(8) It shall be an implied provision of a formal land mortgage that a receiver shall apply all money received by him—

- (a) in discharge of rents, taxes, rates and outgoings;
- (b) in keeping down all annual sums or other payments, and the interest on all principal sums, having priority to the mortgage;
- (c) in payment of his commission, and of the premiums on insurances, if any, properly payable under the mortgage or under this Act, and the cost of executing necessary or proper repairs directed in writing by the mortgagee;
- (d) in payment of the interest accruing due in respect of any principal money due under the mortgage; and
- (e) in or towards discharge of the principal money if so directed in writing by the mortgagee,

and shall pay the residue, if any, to the person who, but for the possession of the receiver, would have been entitled to receive the income of which he is appointed receiver, or who is otherwise entitled to the mortgaged property.

(9) This is an overriding provision.

### *Prohibition of consolidation*

Redemption  
without payment  
of money due on  
other property.

32.—(1) It shall be an implied provision of a formal or informal land mortgage that the mortgagor may redeem without paying any money due under a separate mortgage made by him, or by any person through whom he claims, solely on property other than that comprised in the mortgage which he seeks to redeem.

(2) This is an overriding provision.

## EXPLANATORY NOTES

### *Subsections (3) - (5)*

These subsections reproduce subsections (3), (4) and (6) of section 109 of the Law of Property Act 1925 with no substantive change. The receiver has power to recover money in the name of the mortgagor or the mortgagee and to give receipts. No-one paying need enquire as to the receiver's authority. The receiver is authorised to retain commission.

### *Subsection (6)*

The receiver may exercise the mortgagee's power to insure if the mortgagee so directs. This derives from subsection (7) of section 109 of the Law of Property Act 1925.

### *Subsections (8) and (9)*

Subsection (8) lays down the order of priority in which the receiver is to apply money in his hands, and subsection (9) makes this an overriding provision. These subsections reproduce the effect of subsection (8) of section 109 of the Law of Property Act 1925.

### **Clause 32**

This clause, which is derived from section 93(1) of the Law of Property Act 1925, prohibits consolidation of mortgages, implementing the recommendation in paragraph 6.44 of the Report. It differs from the present law in making the prohibition an overriding provision, instead of making it yield to any contrary intention in one or more of the mortgage deeds.

PART V

LAND MORTGAGE PROVISIONS - ADDITIONAL RULES  
APPLYING ONLY TO PROTECTED MORTGAGES

*Introductory*

Protected mortgages.

33.—(1) Subject to subsection (2) below, in this Act “protected mortgage” means a formal or informal land mortgage other than one made by a body corporate, where the land includes a dwelling-house whether or not it also includes premises (“non-residential premises”) used for other purposes.

(2) A mortgage is not protected if—

- (a) the enforcement of the mortgage would not affect the occupation of the dwelling-house; or
- (b) the dwelling-house is occupied under a service tenancy.

(3) In this section “dwelling-house” includes any building or part of a building which is used as a dwelling.

*Form, contents and copies*

Regulations as to form and contents.

34.—(1) The Secretary of State shall make regulations as to the form and contents of protected mortgages.

(2) The Secretary of State may by regulations make such provision, additional to any provision made by virtue of subsection (1) above, as appears to him to be appropriate with a view to ensuring that any person to whom this subsection applies is made aware—

- (a) of the rights and duties conferred or imposed on him by the mortgage or any document ancillary to it;
- (b) of the protection and remedies available to him under this Act; and
- (c) of any other matters which, in the opinion of the Secretary of State, it is desirable for him to know in connection with the mortgage,

and without prejudice to the generality of this section—

(i) may direct that all the provisions of a protected mortgage (including provisions implied by law) shall be fully set out in it;

(ii) may make such provision as to the typography and lay-out of a protected mortgage as appears to the Secretary of State to be necessary to prevent one part of the mortgage being given excessive or insufficient prominence as compared with another; and

(iii) may provide that specified expressions, when used as described by the regulations, are to be given prescribed meanings, notwithstanding that other meanings are intended by the person using them.

(3) Subsection (2) above applies—

- (a) to the mortgagor;
- (b) to any other person who undertakes an obligation under the mortgage; and



## EXPLANATORY NOTES

### **Clause 33**

Clause 33 defines "protected mortgages". It implements the recommendations made in Part IV of the Report. Subsection (1) defines a protected mortgage as any mortgage, whether formal or informal, where the mortgaged property is an interest in land that includes a dwelling house (defined in subsection (3) as any building or part of a building which is used as a dwelling). Thus mortgages of mixed residential and non-residential property are included. Three types of mortgage are excluded from the protected class. The first, set out in subsection (1), is mortgages where the mortgagor is a body corporate. The second, set out in subsection (2), is mortgages where enforcement of the mortgage would not affect the occupation of the dwelling house. This covers cases where the dwelling house is occupied by someone other than the mortgagor by virtue of an interest binding on the mortgagee and any purchaser from the mortgagee; it also covers cases where the dwelling house is unoccupied. The third exclusion is mortgages where the dwelling house is occupied under a service tenancy.

### **Clause 34**

Clause 34 gives the Secretary of State power to make regulations about the form and content of protected mortgages. This clause, together with clause 35, implements recommendations made in paragraphs 5.1 to 5.4, and 5.9 to 5.11 of the Report.

### *Subsections (2) and (3)*

These subsections allow the Secretary of State to make appropriate provision to ensure that the people listed in subsection (3) are made aware of the matters listed in paragraphs (a) to (c) of subsection (1), in particular by carrying out the measures set out in (i) to (iii) of subsection (1).

*Land Mortgages*

- (c) to any guarantor or other person who undertakes an obligation under an instrument ancillary to the mortgage.
- (4) The Secretary of State may by regulations specify material that is not to be included in or attached to a protected mortgage.
- (5) Regulations under this section—
  - (a) may make different provision in relation to different cases or classes of case;
  - (b) may exclude certain cases or classes of case; and
  - (c) may contain such incidental and supplementary provisions as the Secretary of State thinks fit.

Availability of copies for persons undertaking obligations.

35.—(1) It shall be the duty of a mortgagee under a protected formal land mortgage to provide every person to whom section 34 (2) above applies with a copy of the mortgage.

(2) The Secretary of State may by regulations direct how and when such copies are to be provided.

*Enforcement - General*

Agreements for execution of formal land mortgages to replace informal land mortgages void.

36. Any agreement between the mortgagor and the mortgagee under an informal protected land mortgage which purports —

- (a) to oblige the mortgagor, or to oblige him if specified conditions are fulfilled, to execute a formal land mortgage to replace the informal land mortgage; or
- (b) to permit the mortgagee or some other person, or to permit the mortgagor or some other person if specified conditions are fulfilled, to execute on behalf of the mortgagor a formal land mortgage to replace the informal land mortgage,

is void to the extent that it so purports.

Failure to comply with regulations etc.

37.—(1) If it appears to the court on an application by a mortgagee—

- (a) for the execution of a formal land mortgage to replace a protected informal land mortgage; or
- (b) for an order under section 39, 40, 43 or 44 below,

that the mortgage does not comply with regulations under section 34 above, or that the mortgagee is in breach of his duty under section 35 above to provide a person to whom subsection (2) of that section applies with a copy of it in accordance with regulations under section 35 above, it must refuse to make the order for which application has been made or make the order subject to conditions, unless it appears to it—

- (i) that every person to whom section 34(2) above applies received before the creation of the mortgage as full an explanation of the consequences that the mortgage would have as if there had been no such breach; or
- (ii) that the circumstances are exceptional.

(2) The court shall have power on such an application to order that any costs paid by a person to whom section 34(2) above applies shall

## EXPLANATORY NOTES

### *Subsection (4)*

Subsection (4) provides for regulations specifying material which may not be included in or attached to a protected mortgage.

### *Subsection (5)*

The effect of this subsection is that regulations made under this clause need not necessarily apply to all protected mortgages.

### **Clause 35**

Clause 35 requires a mortgagee under a protected mortgage to provide a copy of the mortgage to every person listed in clause 34(3) (that is, the mortgagor, any guarantor, and any other person undertaking an obligation under the mortgage or any ancillary instrument). The copies are to be provided in circumstances and at times specified by regulations to be made under subsection (2).

### **Clause 36**

Clause 36, which should be read with clause 6, is designed to ensure that a mortgagee under a protected informal mortgage cannot procure the replacement of the informal mortgage by a formal mortgage (and, hence, cannot enforce the mortgage) without first obtaining a court order. It does this by providing that any agreement between mortgagor and mortgagee under a protected mortgage is void in so far as it purports to oblige the mortgagor to execute a formal mortgage to replace an informal mortgage, or to permit the mortgagee or anyone else to execute on the mortgagor's behalf (for example, under a power of attorney).

### **Clause 37**

Clause 37 sets out the consequences of failure to comply with regulations made under clauses 34 and 35, implementing the recommendation made in paragraph 5.12 of the Report.

### *Subsection (1)*

This subsection provides that when a mortgagee who has failed to comply with any regulation applies to the court for an order for the execution of a formal mortgage to replace an informal mortgage under clause 6, or for the enforcement of a formal land mortgage under clause 39 (sale), clause 40 (possession), clause 43 (grant of lease by mortgagee or receiver) or clause 44 (appointment of a receiver), then the court must either refuse to make the order or make it subject to appropriate conditions: it can only make an unconditional order if one of the conditions set out in (i) and (ii) is satisfied.

### *Subsection (2)*

This gives the court additional power to order the recovery of costs incurred by the mortgagor or any guarantor or other person undertaking an obligation under the mortgage or any ancillary instrument.

## *Land Mortgages*

be recoverable.

Requirement of service of enforcement notice before application to court.

**38.—**(1) The court shall not make an order under section 39, 40, 43 or 44 below unless the mortgagee has served an enforcement notice on the mortgagor before applying for the order.

- (2) In this Act “enforcement notice” means a notice specifying—
- (a) steps which the mortgagee requires the mortgagor to take; and
  - (b) any consequences of taking or failing to take them.
- (3) The Secretary of State shall make regulations—
- (a) prescribing the form of enforcement notices; and
  - (b) providing for their service.

### *Sale*

Requirement of court order for sale of dwelling-house.

**39.—**(1) It shall be an implied provision of a protected mortgage that the mortgagee may only exercise a power conferred by section 22(1)(a) above if he has first obtained an order of the court authorising him to do so.

- (2) This is an overriding provision.

Requirement of court order for possession for purpose of sale and cesser of mortgagee’s duty to account for rents and profits.

**40.—**(1) It shall be an implied provision of a protected mortgage that the mortgagee may not take possession of the premises or part of them unless he has first obtained an order of the court authorising him to do so.

- (2) This is an overriding provision.

(3) Subject to the provisions specified in subsection (5) below, the court shall make an order under this section in any case where it appears to it that it is reasonably necessary for the mortgagee to take possession to enable the mortgaged property to be sold.

(4) Subject to the provisions specified in subsection (5) below, if the mortgaged property consists both of non-residential premises and also of a dwelling-house, the court shall make an order authorising the mortgagee to take possession—

- (a) of the non-residential premises or part of them if it appears to it that it is reasonably necessary for the mortgagee to take possession in order to prevent any or any further reduction in the value of the mortgaged property as a whole or to reverse any such reduction that has already occurred; and
- (b) of the dwelling-house if it is satisfied that it is not otherwise possible to prevent or reverse any such reduction.

(5) The provisions mentioned in subsections (3) and (4) above are—

- (a) section 37(1) above;
- (b) section 38(1) above; and
- (c) section 45(6) below.

(6) Where the court makes an order under this section, it may also order that interest under the mortgage shall cease to accrue at the end of the period of 12 weeks beginning with the date of the execution of

## EXPLANATORY NOTES

### **Clause 38**

Clause 38 implements the recommendations in paragraphs 7.12 and 7.13 of the Report that an enforcement notice procedure should be followed in all cases where the mortgagee proposes to enforce a protected mortgage.

#### *Subsection (1)*

Subsection (1) provides that, where a mortgage is protected, a court has no power to make an order for sale (under clause 39) or possession (under clause 40) or the grant of a lease (under clause 43) or the appointment of a receiver (under clause 44) unless an enforcement notice has been duly served.

#### *Subsection (2)*

Subsection (2) provides that an enforcement notice should specify the steps which the mortgagee requires the mortgagor to take, and the consequences of taking or failing to take them.

#### *Subsection (3)*

This subsection provides for regulations to be made prescribing the form of enforcement notices and specifying when and how they are to be served.

### **Clause 39**

This clause implements the recommendation made in paragraph 7.15 of the Report that a mortgagee under a protected mortgage should not be entitled to exercise the power of sale without first obtaining a court order. This requirement is additional to the provisions relating to exercise of the power of sale which are contained in clauses 22 to 26 and which apply to all mortgages.

### **Clause 40**

This contains restrictions on the right of a mortgagee to take possession under a protected mortgage. These restrictions are additional to the provisions relating to possession in clauses 19 to 21 which apply to all mortgages.

#### *Subsections (1) and (2)*

These subsections implement the recommendation in paragraph 7.32 of the Report that a mortgagee under a protected mortgage should not be entitled to take possession without first obtaining a court order.

#### *Subsections (3) - (5)*

These subsections implement the recommendations made in paragraph 7.32 of the Report. Subsection (3) provides that the court must make a possession order if satisfied that it is reasonably necessary for the mortgagee to take possession to enable the property to be sold, unless the court is authorised or required to refuse an order under the clauses listed in subsection (5).

Subsection (4) gives the court additional power to make an order where possession is reasonably necessary to preserve the value of the security, but this power is available only where the mortgaged property consists of mixed residential and non-residential property, and only if the conditions set out in paragraphs (a) and (b) are satisfied. If all these requirements are met, then the court must make an order unless authorised or required to refuse an order under any of the clauses listed in subsection (5).

Subsection (5) lists the provisions which enable or require the court to refuse to make a possession order under subsections (3) or (4). These are clause 37(1) (mortgagor failed to comply with regulations under clauses 34 and 35 about form and content and delivery of copies), clause 38(1) (enforcement notice not duly served), and clause 45(6) (default remedied, threat to security removed, or steps required by enforcement notice have been taken).

#### *Subsection (6)*

Subsection (6), together with clause 46, implements the recommendations in paragraphs 7.30 and 7.31 of the Report. This subsection gives the court making a possession order in respect of a protected mortgage power to order that interest shall cease to accrue under the mortgage twelve weeks (or any other period it thinks fit) after execution of the possession order.

## *Land Mortgages*

the order for possession or, if it is satisfied, on an application by the mortgagee, that it is not reasonable to expect a sale to be completed in 12 weeks, such longer period as appears to it to be reasonable for completion.

(7) The mortgagee is not under a duty by virtue of section 20(1)(b)(ii) or (c)(iii) above to account to the mortgagor for rents and profits that he has received in respect of the premises at a time when interest has ceased to accrue by reason of an order under subsection (6) above or that he ought reasonably to have received at any such time.

(8) The Secretary of State may by order substitute some other number of weeks for the number specified in subsection (6) above.

Additional restriction on powers of mortgagee to sell to himself.

41. An application made by a mortgagee under section 24 above shall not be granted, if the mortgage is a protected mortgage, unless in addition to satisfying the court as mentioned in that section the mortgagee satisfies it that the circumstances are such that on an application under section 39 above it would have made an order under that section authorising sale to some other person.

Title of purchaser not impeachable.

42.—(1) Subject to subsection (2) below, the title of a purchaser from a mortgagee under a protected mortgage shall not be impeachable on the ground that the mortgagee had no power to sell because no order was obtained.

(2) Subsection (1) above does not apply if—

- (a) the mortgagor is in possession; and
- (b) the purchaser has not taken reasonable steps to ascertain whether leave was granted or consent was given.

### *Leasing*

Requirement of court order for lease of dwelling-house.

43.—(1) It shall be an implied provision of a protected mortgage that the mortgagee or a receiver may only grant a lease of the whole or part of any dwelling-house on the land if he has first obtained an order of the court authorising him to do so.

(2) This is an overriding provision.

### *Receivers*

Requirement of court order for appointment of receiver.

44.—(1) It shall be an implied provision of a protected mortgage that the mortgagee may not appoint a receiver unless he has first obtained an order of the court authorising him to do so.

(2) This is an overriding provision.

(3) In deciding whether to make an order the court shall consider the effect that the appointment of a receiver would have on the occupation of any dwelling-house on the land and, if the effect would be to disturb occupation, shall refuse to make an order unless it is satisfied—

- (a) that the object of the appointment is to enable the mortgagee to sell; or

## EXPLANATORY NOTES

### *Subsection (7)*

Subsection (7) provides that if interest ceases to accrue by virtue of subsection (6), then the mortgagee's liability to account under clause 20(1) will correspondingly cease.

### *Subsection (8)*

This subsection gives the Secretary of State power to alter the period of twelve weeks specified in subsection (6).

### **Clause 41**

Clause 41 deals with the new power, contained in clause 24, for the court to authorise a mortgagee to sell to itself. This clause makes it clear that, if the mortgage is protected, the court cannot give leave under clause 24 unless the circumstances are such that the court would have given the mortgagee leave to sell to someone other than itself.

### **Clause 42**

This clause provides that a purchaser from a mortgagee exercising the power of sale under a protected mortgage need not be concerned to see whether an order for sale was obtained, unless the mortgagor is in possession: if the mortgagor is in possession then the purchaser's title is impeachable on the grounds that the mortgagee has no power to sell because no order was obtained, unless the purchaser took reasonable steps to ascertain whether an order was obtained or the mortgagor's consent to the sale was given.

### **Clause 43**

Clause 43 provides that a mortgagee or receiver under a protected mortgage may not exercise their powers to grant leases of all or part of any dwelling-house on the land without first obtaining a court order. This allows leases of non-residential parts of the property to be granted without the need for a court order.

### **Clause 44**

Clause 44 deals with the mortgagee's power to appoint a receiver under a protected mortgage.

### *Subsections (1) and (2)*

These subsections provide that a mortgagee under a protected mortgage may not appoint a receiver without first obtaining a court order.

### *Subsection (3)*

This subsection requires the court to consider the effect that appointment of a receiver would have on the occupation of any dwelling-house on the land: if the effect would be to disturb occupation then the court must refuse to make the order unless satisfied that one or other of paragraphs (a) and (b) applies.

*Land Mortgages*

- (b) that the security cannot be protected properly by any means other than the appointment of a receiver.

*Special jurisdiction of court as to mortgagee's powers*

Jurisdiction of court on applications for certain orders relating to protected mortgages.

45.—(1) Where the mortgagee under a protected mortgage makes any application for an order under section 39, 40, 43 or 44 above or for an order for repayment of the debt secured by the mortgage, the court shall have power, in addition to its other powers—

- (a) subject to subsection (2) below, to order that payments under the mortgage shall be made as specified in the order instead of as they would otherwise be required to be made; and
- (b) if it appears to the court that the mortgagor is likely to be able within a reasonable period to pay any arrears due under the mortgage (whether as originally made or as varied by an order under this subsection), to order the repayment of the arrears on such terms as to amounts and times for payment as it thinks fit.

(2) The court may only exercise the power conferred by subsection (1)(a) above without the consent of the mortgagee—

- (a) if it is satisfied that the mortgaged property remains adequate security for the aggregate of the following—
  - (i) the total amount due to the mortgagee (including all costs and expenses payable by the mortgagor) at the time when the power is exercised; and
  - (ii) the total amount that will become due to him under the mortgage in the future (including any such costs and expenses); and
- (b) it considers it reasonable to exercise the power, having regard to all the circumstances.

(3) On making an order under section 39, 40, 43 or 44 above or at any time before the execution of such an order the court shall have power—

- (a) to stay or suspend execution of the order; and
- (b) if an order for possession has been made, to postpone the date for delivery of possession,

for such period as the court thinks reasonable to enable the mortgagor—

- (i) to comply with an order under subsection (1) above; or
- (ii) to remedy a default not relating to the payment of money due under the mortgage,

and subject to such conditions as it thinks fit for any such purpose.

(4) On making an order under section 39 above or at any time before the execution of such an order the court shall have power, if an event has occurred such as is mentioned in section 22(3)(c) above—

- (a) to stay or suspend execution of the order; or
- (b) if an order for possession has been made, to postpone the date for delivery of possession,



## EXPLANATORY NOTES

### Clause 45

Clause 45 sets out the jurisdiction of the court on an application by a mortgagee to enforce a protected mortgage. It implements the recommendations in paragraphs 7.48 to 7.53 of the Report.

#### *Subsection (1)*

This subsection confers two powers on the court. These powers are exercisable on an application by the mortgagee under a protected mortgage to enforce the mortgage or for repayment of a debt secured by the mortgage. The first power, set out in subsection (1)(a), is to re-schedule payments due under the mortgage: subsection (2) limits the circumstances in which this power may be exercised. The second power, set out in subsection (1)(b), is to order repayment of arrears by such instalments as the court thinks fit, if it appears that the mortgagor is likely to be able to pay off the arrears within a reasonable period. This second power is derived from section 36 of the Administration of Justice Act 1970, as amended.

#### *Subsection (2)*

This subsection relates to the power to re-schedule payments under subsection (1)(a). It provides that the court may not exercise this power without the consent of the mortgagee unless it is satisfied that the property remains adequate security for the sums specified in paragraph (a), and it considers that it is reasonable to do so in all the circumstances.

#### *Subsection (3)*

Subsection (3) gives the court power to delay the effect of an enforcement order for such periods as it thinks reasonable in order to enable the mortgagor to comply with a payment order made under subsection (1) or to remedy a non-financial default. These powers are substantially the same as those the court already enjoys under section 36 of the Administration of Justice Act 1970.

#### *Subsection (4)*

This concerns the making of an order for sale when the ground for sale was the occurrence of an event under clause 22(3)(c) (a substantial threat to the ability of the mortgagor to repay, or to the value of the security). It provides that in such a case the court shall have power (in addition to the powers under subsection (3)) to delay the effect of the order for such period as it thinks reasonable having regard to the prospect of the mortgagor's finances (or the value of the security) being restored.

## *Land Mortgages*

for such period as the court thinks reasonable, having regard to any prospect that there may be of the former state of affairs as to any matter such as is mentioned in that paragraph being restored, and subject to such conditions as it thinks fit, having regard to any such prospect.

(5) Where under the terms of the mortgage 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 the purposes of this section the 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.

(6) The court must refuse to make an order under section 39, 40, 43 or 44 above if it appears to it—

- (a) that the default in issue has been remedied;
- (b) that the threat to the security has been removed; or
- (c) that the mortgagor has taken the steps which the enforcement notice required him to take.

(7) The court may vary or revoke a condition imposed by virtue of this section if it considers it just to do so, having regard to the circumstances.

### *Surrender of possession etc.*

Right of mortgagor to surrender possession and cesser of interest.

46.—(1) It shall be an implied provision of a protected mortgage that if—

- (a) the mortgagee serves an enforcement notice;
- (b) the notice states that the mortgagee intends to apply for an order under section 39 or 40 above; and
- (c) the mortgagor—
  - (i) surrenders possession of the mortgaged property; and
  - (ii) serves on the mortgagee notice in writing that he has done so,

interest under the mortgage shall cease to accrue, subject to subsection (3) below, at the end of the period of 12 weeks beginning with the day on which the mortgagor's notice was served.

(2) This is an overriding provision.

(3) If the court is satisfied, on an application by the mortgagee, that it is not reasonable to expect a sale to be completed in 12 weeks, it may direct that interest shall cease to accrue at the end of such longer period as appears to it to be reasonable for completion.

(4) The mortgagee is not under a duty by virtue of section 20(1)(b)(ii) or (c)(iii) above to account to the mortgagor for rents and profits that he has received in respect of the premises at a time when interest has ceased to accrue under subsection (1) above or by reason of an order under subsection (3) above or that he ought reasonably to have received at any such time.

## EXPLANATORY NOTES

### *Subsection (5)*

This reproduces section 8(1) of the Administration of Justice Act 1973 (where the date due for payment is accelerated by a default, the court may treat payments as not due until the original later date) with no substantive change.

### *Subsection (6)*

This makes it clear that no order may be made if there is no subsisting default or threat to the security, or if all steps required by an enforcement notice have been taken.

### *Subsection (7)*

This makes it clear that any conditions imposed by the court in the exercise of its powers under this clause may be varied or revoked.

### **Clause 46**

Clause 46 makes provision, similar to that contained in clause 40, for interest to cease to accrue under a protected mortgage if the mortgagor surrenders possession in response to an enforcement notice and the mortgagee fails to sell the property within a specified period thereafter. This clause, together with clause 40(6), implements the recommendations in paragraphs 7.34 and 7.35 of the Report in relation to cesser of interest.

### *Subsections (1) and (2)*

These subsections provide that if the mortgagee serves an enforcement notice stating that the mortgagee intends to apply to the court for a sale or possession order, and the mortgagor then surrenders possession and serves written notice to that effect on the mortgagee, interest under the mortgage will cease to accrue 12 weeks after service of the mortgagor's notice.

### *Subsection (3)*

This allows the court to extend the period of twelve weeks if, on an application by the mortgagee, it is satisfied that it is not reasonable to expect a sale to be completed within the twelve weeks.

### *Subsection (4)*

Subsection (4), like subsection (7) of clause 40, provides that for so long as interest is not payable by virtue of these provisions, the mortgagee's liability to account under clause 20(1) correspondingly lapses.

*Land Mortgages*

(5) The Secretary of State may by order substitute some other number of weeks for the number specified in subsection (1) and (3) above.

*[Restrictions on transfer*

Restrictions on transfer of mortgagee's interest.

47.—(1) The mortgagee under a protected mortgage shall not transfer his interest under the mortgage to any other person unless the mortgagor has first given written consent to a transfer to that person or is deemed to have given consent by virtue of subsection (5) below.

(2) The Secretary of State may by regulations—

- (a) require the person proposing to transfer the mortgagee's interest ("the transferor") to give the mortgagor such information relevant to the proposed transfer as may be prescribed;
- (b) prescribe the form of the document by which consent is to be given;
- (c) require the transferor to secure that notice that the transfer has been made is given to the mortgagor; and
- (d) prescribe the form of such a notice and the period after the transfer within which it must be given.

(3) The power conferred by subsection (2) above to require the transferor to give the mortgagor such information relevant to the proposed transfer as may be prescribed includes, without prejudice to its generality, power to require the transferor to give the mortgagor such information about the proposed transferee as may be prescribed.

(4) The mortgagee's interest may be transferred without consent if the mortgagor withholds consent unreasonably.

(5) If—

- (a) the transferor has supplied the mortgagor with all information which regulations under this section require him to supply; and
- (b) the mortgagor has not notified the transferor of his decision on the application for consent before the end of the period of 28 days from the date on which the transferor supplied the last of the required information,

consent shall be deemed to have been given on the last day of that period.

(6) Consent given or deemed to have been given ceases to have effect if the transferor does not transfer his interest before the end of the period of six months after it is given or deemed to have been given, and if consent ceases to have effect, the transferor shall return to the mortgagor any document in the transferor's possession by which the mortgagor gave his consent.

(7) Where a transfer has been made without consent and it appears to the court that the mortgagor did not withhold consent unreasonably, the court, if it appears to be practical to do so, shall order, on the application of the mortgagor—

- (a) that the transfer shall be set aside; and

## EXPLANATORY NOTES

### *Subsection (5)*

This gives the Secretary of State power to vary the period of twelve weeks specified in this clause.

### **Clause 47**

Clause 47 is included here in square brackets as a suggested clause that could be incorporated into this Bill if it was thought desirable to enact legislation restricting transfers of protected mortgages: see paragraphs 6.26 and 6.27 of the Report. The Bill could be enacted with or without inclusion of this clause.

### *Subsection (1)*

This subsection prohibits transfer of a protected mortgage without the prior written consent of the mortgagor. The consent may be actual, or deemed under subsection (5). It should be read with subsection (4) (mortgage may be transferred without consent if consent unreasonably withheld).

### *Subsections (2) and (3)*

These subsections provide for regulations to be made laying down the process by which consent is sought and given.

### *Subsections (4) and (5)*

Subsection (4) allows the mortgage to be transferred without consent if consent is unreasonably withheld: subsection (5) deems consent to have been given if the mortgagor has not notified the mortgagee of his decision within a specified period.

### *Subsection (6)*

This makes a consent (whether given or deemed to have been given) cease to have effect if the transfer is not completed within six months.

### *Subsections (7) and (8)*

These subsections deal with the consequences of transferring without consent. If it is practical to do so, the court must order the transfer to be set aside and the mortgage to re-vest in the transferor. If this is not practical (for example because the transferor no longer exists, or is no longer empowered to hold mortgages of this description, or no longer capable of doing so) then the maximum interest rate payable under the mortgage will be frozen at the rate payable at the time when consent should have been sought.

*Land Mortgages*

(b) that the transferor's interest shall vest in him again.

(8) If it is not practical to make an order under subsection (7) above, the court shall order that the maximum rate of interest payable under the mortgage from the date of the order shall be that payable on the date when the transferor applied or should have applied for consent.]

*Void terms*

Void terms as to interest and redemption.

48.—(1) Any term of a protected mortgage is void if it purports to provide—

- (a) that the mortgagor shall pay interest on amounts unpaid in breach of the terms of the mortgage at a rate exceeding the rate at which it would fall to be paid if there had been no breach;
- (b) that the mortgagor is to give notice of intention to redeem the mortgage; or
- (c) that the mortgagee is entitled to charge interest in lieu of notice to redeem.

(2) Any term of a protected mortgage which postpones the right to redeem or otherwise impedes redemption is void unless the land in which the mortgaged interest subsists includes non-residential premises.

Rebate on early payment.

49.—(1) The Secretary of State may by regulations provide for the allowance of a rebate to a mortgagor under a protected mortgage where, on breach of the terms of the mortgage or for any other reason, his indebtedness is wholly or partly discharged earlier than required under the terms of the mortgage.

(2) Regulations under subsection (1) above may provide for calculation of the rebate by reference to any sums paid or payable by the mortgagor under or in connection with the mortgage (whether to the creditor or some other person).

Regulation of variation or non-variation of interest rate under protected mortgage.

50.—(1) Without prejudice to the generality of any of its other powers if the court is satisfied on an application by the mortgagor under a protected mortgage that the mortgagee has unreasonably varied or failed to vary the interest rate under the mortgage, it may order that interest shall be paid at such rate as it considers reasonable.

(2) For the purpose of assessing whether or not a variation or failure to vary was reasonable the court shall have regard in particular to the ratio of the rate under the mortgage to interest rates prevailing—

- (a) at the time the mortgage was created; and
- (b) at the time of the variation or the time at which the mortgagor alleges that the mortgagee ought to have varied the interest rate but failed to do so.

(3) It is for the mortgagor to satisfy the court that the variation or failure to vary was unreasonable.

## EXPLANATORY NOTES

### **Clause 48**

Clause 48 sets out various provisions which are void if in a protected mortgage.

#### *Subsection (1)(a)*

This invalidates any provision increasing the rate of interest payable on default, implementing the recommendation made in paragraph 6.30 of the Report. It derives from section 93 of the Consumer Credit Act 1974.

#### *Subsection (1)(b) and (c)*

These paragraphs invalidate requirements that the mortgagor should give notice to redeem, or pay interest in lieu of notice. They implement the recommendation made in paragraph 6.43(b) of the Report.

#### *Subsection (2)*

Subsection (2) implements the recommendation in paragraph 6.43(a) of the Report. It prohibits any postponement of redemption, except in protected mortgages where the property includes non-residential premises: if it does include non-residential premises, the mortgagor may still challenge a postponement of redemption under clause 51(1)(d). Subsection (2), together with clause 51(1)(d), replaces the equitable jurisdiction to set aside postponements of redemption.

### **Clause 49**

Clause 49 provides for regulations to be made allowing an appropriate rebate to a mortgagor who repays sums due under a protected mortgage prematurely. It implements the recommendation in paragraph 6.43(c) of the Report, and derives from section 95 of the Consumer Credit Act 1974.

### **Clause 50**

Clause 50, together with clause 51, implements the recommendations about regulation of interest rates made in paragraphs 6.36 to 6.41 of the Report. This clause gives the court power to alter the rate of interest payable under a protected mortgage if satisfied by the mortgagor that the mortgagee unreasonably varied or failed to vary the rate payable. Unreasonableness is to be assessed by reference to subsection (2). Subsection (4) allows the Secretary of State to exempt specified mortgagees from this clause.

(4) The Secretary of State, after consultation with the Director General of Fair Trading, may direct that this section shall not apply to mortgages under which the mortgagee is a body specified in the direction.

PART VI  
MISCELLANEOUS

*Reopening mortgages and setting aside mortgage term*

Jurisdiction of court to reopen mortgages and set aside terms.

51.—(1) The court may reopen a mortgage with a view to doing justice between the parties if it appears to the court—

- (a) that principles of fair dealing were contravened when the terms of the mortgage were being settled;
- (b) that the effect of the terms of the mortgage, at the time when the question of reopening it falls to be determined, is to give the mortgagee rights substantially greater than or different from those necessary to make the mortgaged property adequate security for the liabilities secured by the mortgage;
- (c) that the mortgage requires payments to be made (whether unconditionally or on certain contingencies) which are exorbitant; or
- (d) that the mortgage includes a term which postpones the right to redeem or otherwise impedes redemption but which is not void under section 48(2) above.

(2) The powers conferred on the court by this section are exercisable on the application of the mortgagor or the mortgagee and, without prejudice to the generality of this subsection—

- (a) on an application by the mortgagee to enforce the mortgage or for repayment of any sum due under it or under any instrument ancillary to it; and
- (b) on an application by the mortgagee for an order under section 6 above.

(3) In reopening the mortgage the court may, by order,—

- (a) direct that the mortgage shall have effect subject to modifications;
- (b) require the mortgagee to repay the whole or part of any sum paid under the mortgage or any related agreement by the mortgagor or any person to whom section 34(2) above applies, whether it was paid to the mortgagee or to any other person.

(4) In determining whether it ought to reopen a mortgage on either of the grounds specified in subsection (1)(b) and (d) above the court shall disregard the question whether the terms of the mortgage were freely negotiated between parties of equal bargaining power.

(5) If the court determines to reopen a mortgage on either of those grounds, it may direct that the mortgagor shall pay the mortgagee such compensation as the court thinks fit, in addition to making any other order which this section gives it power to make.



## EXPLANATORY NOTES

### **Clause 51**

Clause 51 sets out the jurisdiction of the court to reopen and set aside the terms of any mortgage (whether protected or non-protected). It implements the recommendations in Part VIII of the Report. This jurisdiction replaces the extortionate credit bargain jurisdiction enacted in Part IX of the Consumer Credit Act 1974 (which ceases to apply to land mortgages by virtue of clause 60(e)) and the equitable jurisdiction of the court to set aside a provision of a mortgage which constitutes a clog or fetter on the equity of redemption (which is abolished by clause 64(6)).

### *Subsection (1)*

Subsection (1) implements the recommendation in paragraph 8.5 of the Report. It gives the court power to reopen the mortgage to do justice between the parties if one of the conditions set out in paragraphs (a) to (d) applies.

### *Subsection (2)*

This subsection, together with subsection (3) and clauses 60(e) and 64(6), implements the recommendations in paragraph 8.8 of the Report. Subsection (2) makes it clear that the powers conferred by the clause are available on the application of mortgagor or mortgagee, including (but not confined to) applications to enforce the security or for payment of money under the mortgage, and applications to replace an informal mortgage with a formal mortgage.

### *Subsection (3)*

Subsection (3) makes it clear that in reopening a mortgage the court may vary its terms and order the repayment of any sums paid under it or any related agreement, whether by the mortgagor or by any other person.

### *Subsections (4) and (5)*

These subsections implement the recommendation in paragraph 8.6 of the Report. They relate to cases where the ground for reopening the mortgage is either paragraph (b) of subsection (1) (the mortgage gives the mortgagee rights substantially greater than or different from those necessary to make the mortgaged property adequate security for the liabilities secured) or paragraph (d) (the mortgage includes a term postponing or impeding redemption). Subsection (4) provides that in deciding whether to reopen the mortgage on one of these two grounds, the court must disregard the question whether the terms were freely negotiated between parties of equal bargaining power; subsection (5) provides that if the court does decide to reopen the mortgage on either of these two grounds, it has power to order the mortgagor to pay the mortgagee whatever compensation the court thinks fit.

*Land Mortgages*

(6) In considering whether to exercise the powers conferred on it by this section and the manner in which it ought to exercise any such powers the court shall have regard to such matters as it considers relevant and, without prejudice to the generality of this subsection, to any of the following matters that it considers relevant—

- (a) interest rates prevailing—
  - (i) at the time the mortgage was created; and
  - (ii) at the time of any variation of the interest rate under the mortgage or any time at which the mortgagor alleges that the mortgagee ought to have varied the interest rate but failed to do so;
- (b) any relationship between the mortgagor and the mortgagee which existed at the time when the mortgage was created;
- (c) the mortgagor's financial standing at the time when the mortgage was created relative to the mortgagee's financial standing at that time;
- (d) the degree to which, at the time when the mortgage was created, the mortgagor was under financial pressure;
- (e) the nature of any such pressure;
- (f) the degree of risk accepted by the mortgagee, having regard to the value of the mortgaged property and the mortgagor's financial standing; and
- (g) where the mortgagor is an individual his age, experience, business capacity and state of health at the time when the mortgage was created.

*Limit on number of mortgagees under formal land mortgage*

Effect of  
purported  
formal land  
mortgage in  
favour of more  
than four  
persons.

52. Where a formal land mortgage purports to be made in favour of more than four persons—

- (a) only the four first named in the mortgage are the mortgagees; and
- (b) they shall hold the mortgaged property upon the statutory trusts mentioned in section 35 of the Law of Property Act 1925 in like manner as if the mortgage money had belonged to them on a joint account but without prejudice to the beneficial interests in the mortgage money and interest.

1925 c.20

*Covenants for title*

Covenants for  
title on creation  
of formal or  
informal land  
mortgage.

53. Section 76 of the Law of Property Act 1925, including Parts III and IV of Schedule 2 to that Act, shall have effect as if—

- (a) any reference to a conveyance or a conveyance by way of mortgage included a reference to a formal or informal land mortgage; and
- (b) in relation to a formal or informal land mortgage any reference to a person who conveys were a reference to the mortgagor,  
cognate expressions being construed accordingly.

## EXPLANATORY NOTES

### *Subsection (6)*

Subsection (6) requires the court considering the exercise of its powers under this clause to have regard to such matters as it thinks relevant, including (but not confined to) the matters listed in paragraphs (a) to (g).

### **Clause 52**

This reproduces section 34(2) of the Law of Property Act 1925 in so far as it relates to mortgages, with no substantive change.

### **Clause 53**

This amends section 76 of the Law of Property Act 1925 so that the covenants for title set out in Parts III and IV of Schedule 2 to the 1925 Act apply to formal and informal land mortgages.

## *Land Mortgages*

### *Relief against forfeiture*

Relief for mortgagees under formal and informal land mortgages.

54. Section 146(4) and (5) of the Law of Property Act 1925 shall have effect as if any reference to an under-lessee included a reference to a mortgagee under a formal or informal land mortgage.

1925 c.20

### *Transfers*

Transfers of mortgages.

55. A deed executed by a mortgagee under a land mortgage purporting to transfer the mortgage shall, unless a contrary intention is expressed in it, and subject to any provisions contained in it, operate to transfer to the transferee—

- (a) the right to demand, sue for, recover and give receipts for, the mortgage money or the unpaid part of it, and the interest then due, if any, and thenceforth to become due on it; and
- (b) the benefit of all securities for it, and the benefit of and the right to sue on all covenants with the mortgagee, and the right to exercise all powers of the mortgagee; and
- (c) all the interest in the mortgaged property then vested in the mortgagee subject to redemption, but subject to the right of redemption then subsisting.

Overreaching on transfer.

56. A transfer by deed of a mortgage to a purchaser shall overreach any equitable interest or power affecting the mortgage, whether or not the purchaser has notice of that interest or power, if any capital money arising from the transaction is paid to the transferor.

### *Discharges etc.*

Discharge of land mortgage.

57. A mortgage is discharged if the mortgagor discharges all his liabilities under it.

Standard form of discharge for formal land mortgages.

58.—(1) The Secretary of State may by regulations prescribe a standard form of discharge of a formal land mortgage or different forms of discharge for different descriptions of such mortgages.

(2) A standard form need not be used, but a discharge in a standard form—

- (a) operates as a good receipt for the money due under the mortgage; and
- (b) operates in favour of a purchaser as sufficient evidence of discharge,

if the form used is the form prescribed for a mortgage of that description.

(3) Regulations under this section shall be made by statutory instrument.

(4) A statutory instrument containing any such regulations shall be laid before Parliament after being made.

## EXPLANATORY NOTES

### **Clause 54**

This enables mortgagees under formal and informal land mortgages to apply for relief against forfeiture of a mortgaged lease, in the same circumstances in which mortgagees may apply for relief under the present law.

### **Clause 55**

This reproduces section 114(1) of the Law of Property Act 1925 without substantive change.

### **Clause 56**

This clause deals with the overreaching effect of a transfer of the mortgage.

### **Clause 57**

Clause 57 implements the recommendation in paragraph 6.45(a) of the Report, makes it clear that a mortgage is discharged by the discharge of all obligations under it, without need for any formalities.

### **Clause 58**

Clause 58 implements the recommendations in paragraph 6.45(b) and (c) of the Report.

### *Subsection (1)*

Subsection (1) provides for standard form discharges to be produced by regulations.

### *Subsection (2)*

Subsection (2) makes it clear that the standard forms need not be used, but that if they are used they have the effect described in paragraphs (a) and (b).

*Land Mortgages*

Effect of  
advance on joint  
account[j900]

59.—(1) Where—

(a) in a mortgage or transfer of a mortgage the sum, or any part of the sum, advanced or owing is expressed to be advanced by or owing to more persons than one out of money, or as money, belonging to them on a joint account; or

(b) a mortgage or transfer of a mortgage is made to more persons than one, jointly,

the mortgage money, or other money or money's worth, for the time being due to those persons on the mortgage shall, as between them and the mortgagor, be deemed to be and remain money or money's worth belonging to those persons on a joint account.

(2) Subsection (2) of section 58 above shall have effect in relation to a receipt in a form prescribed by regulations under that section which is given—

(a) by the survivors or last survivor of persons to whom subsection (1) above applies;

(b) by the personal representative of the last survivor,

shall be a complete discharge for all money or money's worth for the time being due, notwithstanding any notice to the payer of a severance of the joint account.

(3) This section applies if and so far as a contrary intention is not expressed in the mortgage or transfer, and has effect subject to the terms of the mortgage or transfer.

PART VII

GENERAL AND SUPPLEMENTARY

Exclusion of  
provisions of  
Consumer  
Credit Act 1974.  
1974 c. 39.

60. The following provisions of the Consumer Credit Act 1974 shall not apply in relation to land mortgages, namely—

(a) Part V;

(b) sections 76 to 78, 81 and 86;

(c) sections 87 to 89, 93 to 96 and 103;

(d) sections 105, 112, 113 and 126; and

(e) Part IX.

Notices etc.  
1925 c.20.

61.—(1) Section 196 of the Law of Property Act 1925 shall have effect in relation to notices under this Act as it has effect in relation to notices under that Act.

(2) Unless the mortgagor has received notice of a transfer of the mortgage, and also notice of the name and address of the transferee, any notice or other instrument which he serves on the transferor as mortgagee shall be deemed to have been duly served on the mortgagee.

Regulations and  
orders.

62.—(1) Regulations and orders under this Act shall be made by statutory instrument.

(2) A statutory instrument containing any such regulations or order, other than an order under section 66 below, shall be subject to

## EXPLANATORY NOTES

### **Clause 59**

This reproduces section 111 of the Law of Property Act 1925 without substantive change.

### **Clause 60**

Clause 60 implements the recommendation in paragraph 9.6 of the Report that the Consumer Credit Act 1974 should cease to apply to land mortgages in so far as it regulates the form, content and enforcement of mortgages, but should continue to apply to the extent that it regulates the carrying on of the business of mortgage lending. Accordingly, it provides that the following provisions of the 1974 Act shall not apply to formal and informal land mortgages:-

Part V (entry into agreements, including regulation of their form and content and provision of copies): in effect, this is replaced, in so far as it affects land mortgages, by clauses 33 and 35;

sections 76 to 78 (replaced by the clause 36 enforcement notice procedure) and 81 to 86;

sections 87 to 89 (replaced by the clause 36 enforcement notice procedure), section 93 (replaced by clause 44(1)(a)), sections 94 to 96 (replaced by clauses 44 and 45), and section 103;

section 105 (replaced by clause 33), sections 112 and 113, and section 126 (replaced by clauses 37, 38, 41 and 42 in so far as they require a court order for enforcement of a protected mortgage);

Part IX (replaced by clause 48).

### **Clause 61**

Clause 61 deals with notices.

### **Clause 62**

Clause 62 makes provision for the making of orders and regulations under the Act.

*Land Mortgages*

annulment in pursuance of a resolution of either House of Parliament.

Application to land in which there is Crown interest.

63. This Act applies to land in which there is an interest belonging to Her Majesty in right of the Crown, or belonging to a government department, or held in trust by Her Majesty for the purposes of a Government department.

Consequential amendments, repeals etc.

64.—(1) The enactments mentioned in Schedule 1 to this Act shall have effect with the amendments there specified (being amendments consequential on the foregoing provisions of this Act).

(2) The enactments mentioned in Schedule 2 to this Act are repealed to the extent specified in the third column of that Schedule.

1925 c.20.

(3) The repeal of section 94(3) of the Law of Property Act 1925 does not affect priority acquired as mentioned in the proviso to that subsection.

(4) The power to make an order of foreclosure in relation to an interest in land is abolished.

(5) Nothing in subsection (4) above—

(a) affects any order of foreclosure made before that subsection comes into force; or

(b) prevents the taking of any step following such an order.

(6) The equitable jurisdiction of the court to set aside any provision of a mortgage which constitutes a clog or fetter on the equity of redemption is abolished.

Transitional provisions.

65.—(1) Where—

(a) a person agrees before the commencement of this Act to mortgage any property on the occurrence of an event; and

(b) the event occurs after the commencement,

the equitable charge arising over the property by virtue of the agreement shall be an informal land mortgage.

(2) Where a person—

(a) agrees before the commencement of this Act to mortgage property he subsequently acquires; and

(b) after its commencement acquires property to which that agreement applies,

the equitable charge arising over the property by virtue of the agreement shall be an informal land mortgage.

(3) Where—

(a) a person agrees before the commencement of this Act to create a floating charge over any property; and

(b) the charge crystallises after the commencement,

the equitable charge arising over the property by virtue of the agreement shall be an informal land mortgage.

(4) The provisions of this Act specified in subsection (5) below apply to mortgages of interests in land created before the com-



## EXPLANATORY NOTES

### **Clause 63**

This deals with application to the Crown: see paragraph 9.12 of the Report.

### **Clause 64**

This deals with consequential amendments and repeals.

#### *Subsection (3)*

This preserves the priority of mortgages in relation to tacking of further advances before 1925.

#### *Subsections (4) and (5)*

These subsections abolish the remedy of foreclosure, implementing the recommendation in paragraph 7.26 of the Report. Subsection (5) preserves the old law in relation to orders of foreclosure made before abolition comes into effect.

#### *Subsection (6)*

Subsection (6) implements the recommendation in paragraph 8.8 of the Report that the court's equitable jurisdiction in relation to clogs and fetters of the equity of redemption should be abolished. The equitable jurisdiction is replaced by that conferred by clause 51.

### **Clause 65**

Clause 65 contains transitional provisions, implementing the recommendations in paragraphs 9.7 to 9.10 of the Report.

#### *Subsections (1) - (3)*

These subsections deal with mortgages arising after the commencement of the Act in consequence of pre-commencement agreements.

#### *Subsections (4) and (5)*

These subsections apply the clauses listed in subsection (5) (which relate to the protection, enforcement and redemption of the security) to mortgages created before the commencement of the Act.

*Land Mortgages*

mencement of this Act, any reference in them to a formal land mortgage being construed for this purpose as including a reference—

- (a) to a mortgage by demise or sub-demise;
- (b) to a charge by way of legal mortgage; and
- (c) to an equitable mortgage or charge made by deed.

(5) The provisions mentioned in subsection (4) above are—

- section 24;
- section 25;
- section 26;
- section 27;
- section 29;
- section 30;
- section 31;
- section 32;
- section 33;
- section {j033};
- section 40;
- section 41;
- section 43;
- section 44;
- section 45;
- section 46;
- [section 47;]
- section 48;
- section 50;
- section 51;
- section 55
- section 56
- section 57;
- section 58;
- section 59;
- section 60; and
- section 64.

(6) Section 45 above shall have effect in relation to an application such as is referred to in subsection (1) of that section which is begun before the date on which that section comes into force unless—

- (a) judgment on the application has been given, or an order made for delivery of possession of the mortgaged property; and
- (b) the judgment or order was executed before that date.

Commencement.     **66.**—(1) [Subject to subsection (2) below,] this Act, except this section and section 67 below, shall come into force on such day as the Secretary of State may by order appoint.

## EXPLANATORY NOTES

### **Clause 66**

This deals with the commencement of the Act.

*Land Mortgages*

[(2) The Secretary of State may by order appoint a day for the coming into force of section 47 above and of section 65 above so far as it relates to that section different from that appointed for the coming into force of the other provisions of this Act.]

Citation and  
extent.

67.—(1) This Act may be cited as the Land Mortgages Act 1991.

(2) This Act extends to England and Wales only.

## EXPLANATORY NOTES

### **Clause 67**

This deals with the short title and extent.

SCHEDULES

Section 64.

SCHEDULE 1

CONSEQUENTIAL AMENDMENTS

*Settled Land Act 1925*

1925 c.18.

1. The Settled Land Act 1925 shall be amended as follows.

2.—(1) In subsection (1)(iii) of section 16 (enforcement of equitable interests and powers against estate owner)—

- (a) after the words “equitable charge”, in the first place where they occur, there shall be inserted the words “or informal land mortgage”;
- (b) for the words “legal estate or charge by way of legal mortgage” there shall be substituted the word “formal land mortgage”; and
- (c) for the words “equitable charge”, in the second place when they occur, these shall be substituted the words “informal land mortgage”.

(2) The following shall be substituted for the proviso to section 16(1)—

“Provided that, so long as the settlement remains subsisting, any formal land mortgage so created shall take effect and shall be expressed to take effect subject to any equitable charges, informal land mortgages or powers of charging subsisting under the settlement which have priority to the interests or powers of the person or persons by or on behalf of whom the money is required to be raised or legal effect is required to be given to the equitable charge or informal land mortgage, unless the persons entitled to the prior charges or informal land mortgages or entitled to exercise the powers consent in writing to the same being postponed, but it shall not be necessary for such consent to be expressed in the instrument creating the formal land mortgage.”

(3) In section 16(4) for the words “legal mortgage” there shall be substituted the words “formal land mortgage”.

3.—(1) In subsection (1) of section 72 (completion of transactions by conveyances) for the words from “so that” to the end there shall be substituted the words “any mortgage shall be a formal land mortgage”.

(2) In subsection (2) of that section—

- (a) after the word “interests”, in the second place where it occurs, there shall be inserted the word “mortgages,”; and
- (b) after the words “charges by way of legal mortgage”, in both places where they occur, there shall be inserted the words “or formal land mortgages”.

4 In subsection (2) of section 82 (land acquired may be made a substituted security for released charges)—

*Land Mortgages*

- SCH. 1
- (a) for the words “legal estate or charge by way of legal mortgage” there shall be substituted the words “formal land mortgage; and
  - (b) for the words “subjected to such interest or charge “there shall be substituted the words “so subjected”.

*Trustee Act 1925*

- 1925 c.19.
5. In subsection (2) of section 10 of the Trustee Act 1925 for the words from “charge”, in the first place where it occurs, to “charge or” there shall be substituted the words “formal land mortgage, such”.

*Law of Property Act 1925*

- 1925 c.20
6. The following subsection shall be inserted after that section 1(2)(a) of the Law of Property Act 1925-
- “(2A) A charge by way of legal mortgage is capable of subsisting or of being conveyed at law.”.
- 7.—(1) In subsection (1)(b)(ii) of section 3 of that Act (manner of giving effect to equitable interests and powers) for the words “legal estates” there shall be substituted the words “formal land mortgages”.
- (2) In subsection (2) of that section, for the words “legal mortgage” there shall be substituted the words “formal land mortgage”.

*Administration of Estates Act 1925*

- 1925 c.23.
8. In subsection (1)(i) of the Administration of Estates Act 1925 (powers of management) for the words “legal mortgage” there shall substituted the words “formal land mortgage”.

*Land Registration Act 1925*

- 1925 c.39.
9. The Land Registration Act 1925 shall be amended as follows.
10. The following paragraph shall be added at the end of subsection (1) of section 18 (powers of disposition of registered freehold and section 21 (powers of disposition of registered leasehold), as paragraph (f) of the former and paragraph (e) of the latter—
- “( ) grant a formal land mortgage of the registered land or any part thereof”.
- 11.—(1) In subsection (1) of section 27, after the word “effect” there shall be inserted the words “, subject to section 27A below,”
- (2). The following section shall be inserted after that section—
- “Formal land mortgages. 27A.—(1) A registered charge created after the commencement of the Land Mortgages Act 1991 shall take effect as a formal land mortgage.

(2) Any such charge shall take effect from the date of the delivery of the deed containing the formal land mortgage, but subject to the estate or interest of any person (other than the proprietor of the land) whose

*Land Mortgages*

SCH. 1

estate or interest (whenever created) is registered or noted on the register before the date of registration of the charge.”.

12. In section 32 (provisions when charge registered in names of several proprietors) after the words “mortgage term implied or comprised in the charge” there shall be inserted the words “or, as the case may be, the formal land mortgage”.

13. In subsection (5) of section 33 (transfer of charges) after the words “term or subterm” there shall be inserted the words “or formal land mortgage”.

14. In subsection (1) of section 34 (powers of proprietor of charge) for the words “conferred by law on the owner of a legal mortgage” there shall be substituted the words “of a mortgagee under a formal land mortgage”.

15. In subsection (2) of section 35 (discharge of registered charge) after the word “charge”, in the first place where it occurs, there shall be inserted the words “which was registered before the Land Mortgages Act 1991 came into force”.

*Coal Act 1938*

1938 c.52.

16. In subsection (1) of section 44 of the Coal Act 1938 (interpretation of Part I of the Act) in paragraph (b) of the definition of “claiming under” after the the words “charge by way of legal mortgage” there shall be inserted the words “or formal land mortgage,”.

*Landlord and Tenant Act 1954*

1954 c.56.

17.—(1) In subsection (4) of section 36 of the Landlord and Tenant Act 1954 (carrying out of order for new tenancy) after the word “mortgage” there shall be inserted the words “created before the Land Mortgages Act 1991 came into force”.

(2) The following subsection shall be inserted after that subsection—

“(5) A lease executed or agreement made under this section, in a case where the interest of the lessor is subject to a formal land mortgage, shall be deemed to be one authorised by section 27 of the Land Mortgages Act 1991 (which sets out powers of leasing where there is such a mortgage).”.

*National Parks and Access to the Countryside Act 1949*

1949 c.97

18. In subsection (9) of section 104 of the National Parks and Access to the Countryside Act 1949 (general provision as to appropriation and disposal of land) for the words “mortgage or charge” there shall be substituted the words “ or mortgage”.



*Land Mortgages*

SCH. 1

*Cathedrals Measure 1963*

1963 No.2

19. In subsection (1)(a) of section 20 of the Cathedrals Measure 1963 (acquisition and disposal of land by cathedral bodies) for the words "mortgage or charge" there shall be substituted the words "or mortgage".

*Land Charges Act 1972*

1972 c.61

20. In subsection (1)(b) of section 16 of the Land Charges Act 1972 (general rules)—

- (a) after the words "general equitable charge," there shall be inserted the words "formal land mortgage, informal land mortgage,"; and
- (b) after the word "the", in the fourth place where it occurs, there shall be inserted the words "mortgage or other".

21. In subsection (1) of section 17 of that Act (interpretation) before the definition of "judgment" there shall be inserted—

““formal land mortgage” and “informal land mortgage” have the same meanings as in the Land Mortgages Act 1991;”.

*Local Land Charges Act 1975*

1975 c.76

22. The following section shall be substituted for section 7 of the Local Land Charges Act 1975 —

“Effect of registering certain financial charges.

1925 c.20

7.—(1) A local land charge falling within section 1(1)(a) above and created before the Land Mortgages Act 1991 came into force shall, when registered, take effect as if it had been created by a deed of charge by way of legal mortgage within the meaning of the Law of Property Act 1925 , but without prejudice to the priority of the charge.

(2) A local land charge falling within section 1(1)(a) above and created after the Land Mortgages Act 1991 came into force shall, when registered, take effect as if it had been created by a formal land mortgage within the meaning of that Act, but without prejudice to the priority of the charge.”.

*Rent Act 1977*

1977 c.42

23. In paragraph 2(e)(i) of Part V of Schedule 15 to the Rent Act 1977 (grounds for possession) after the words “or by section 101 of the Law of Property Act 1925” there shall be inserted the words “or section 21 of the Land Mortgages Act 1991”.

*Matrimonial Homes Act 1983*

1983 c.19

24. In subsection (10) of section 2 of the Matrimonial Homes Act 1983 —

- (a) at the end of paragraph (b) there shall be added the words “or of a formal land mortgage or informal land mortgage within

*Land Mortgages*

SCH. 1

the meaning of the Land Mortgages Act 1991"; and  
 (b) for the word "(which" there shall be substituted the words  
 "or, as the case may be, section 9 of that Act of 1990 (each  
 of which".

Section 64.

SCHEDULE 2  
 ENACTMENTS REPEALED

Chapter	Short title	Extent of repeal
15 & 16 Geo.5 c.18.	Settled Land Act 1925.	Section 16(5)
15 & 16 Geo.5 c.20.	Law of Property Act 1925.	Section 1(2)(c). In section 3(1)(b)(ii) the words "for raising the money by way of legal mortgage or" Sections 87 to 96. Section 98. Sections 100 to 120. Schedules 3 and 4. In Schedule 5, Forms 1 and 2.
15 & 16 Geo.5 c.21.	Land Registration Act 1925.	In section 18, in subsection (1)(e), the words from "(but" to "thereto)", and subsection (4). In section 21, in subsection (1)(d), the words from "(but" to "thereto)", and subsection (4).
1970 c.31.	Administration of Justice Act 1970.	Section 36. Section 38A. Section 39.
1973 c.15.	Administration of Justice Act 1973.	Section 8. In section 20(1)(b), the word "8".
1974 c. 39.	Consumer Credit Act 1974.	In Schedule 4, in Part I, paragraph 30.
1986 c.5.	Agricultural Holdings Act 1986.	In Schedule 14, paragraph 12.
1986 c.53.	Building Societies Act 1986.	In Schedule 4, paragraph 2.

## APPENDIX B

### Individuals and Organisations who responded to Working Paper No. 99

Agricultural Mortgage Corporation plc  
Association of British Insurers  
Association of County Court and District Registrars  
Building Societies Association  
Building Societies Commission  
City of London Law Society  
Committee of London and Scottish Bankers  
Conveyancing Standing Committee  
The Rt Hon. Lord Justice Dillon  
Family Law Bar Association  
Mr S. Farren, Solicitor  
Finance Houses Association  
Goughs, Solicitors  
Halifax Building Society  
Mr Alexander Hill-Smith, Barrister  
H.M. Land Registry  
Holborn Law Society  
Institute of Legal Executives  
Mr J. B. Jennings, Member of the Council of the Institute of Legal Executives  
Mr Howard Jones, Solicitor to Coventry Legal & Income Rights Service  
Law Centres Federation  
The Law Society  
Mr J. R. Lingard, Solicitor  
Mr P. M. Leigh  
Linklaters & Paines, Solicitors  
Lord Chancellor's Department  
Mr D. G. Marsh, Member of the Council of the Institute of Legal Executives  
National Chamber of Trade  
National Consumer Council  
Office of Fair Trading  
Mr D. C. Orgles  
Dr Sebastian Poulter  
Ralton & Co., Solicitors  
Royal Institute of Chartered Surveyors  
Professor Bernard Rudden and Dr Stuart Anderson  
Mr Paul Rees, Barrister  
Professor L. A. Sheridan  
Professor James C. Smith  
Mr E. H. Thomas, Solicitor  
The Hon. Mr Justice Walton

## APPENDIX C

### Participants in the Seminar on Land Mortgages held at The Law Commission on 31 August 1987

Mr Ashurst (Solicitor to the Derbyshire Building Society, representing the Building Societies Association)  
Mr Bird (Registrar, Bristol County Court; representing the Association of County Court and District Registrars)  
Mr Bridgeman (Building Societies Commission)  
Mr Crosbie (Building Societies Commission)  
Ms Chirnside (Law Society)  
Mr Corlett (Law Society)  
Mr Evans (Committee of London and Scottish Bankers)  
Mr Pickerill (Lloyds Bank plc; representing the Committee of London and Scottish Bankers)  
Ms Goriely (National Consumer Council)  
Mr Hall (Associates Capital Corporation Ltd.; representing the Finance Houses Association)  
Mr Lingard (solicitor, Norton Rose)  
Mr Matthews (Department of the Environment)  
Mr McConnell (Sheffield Law Centre; representing the Law Centres Federation)  
Mr Wasilewski (Office of Fair Trading)  
Mr Watts (Office of Fair Trading)  
Mr Wood (H.M. Land Registry)

#### *Representing the Law Commission:*

Professor J. T. Farrand  
Mr T. M. Aldridge  
Professor Brenda Hoggett  
Ms Alison Clarke  
Mr Gasson  
Mrs Hand  
Mr Caldwell  
Ms Gilding  
Mr Lockey  
Mr Bently

APPENDIX D  
STATEMENT OF PRACTICE  
ON  
THE TRANSFER OF MORTGAGES

issued by

The Department of the Environment and H.M. Treasury Working Group  
on the Secondary Mortgage Market

November 1989

TRANSFER OF MORTGAGES

*Statement of Practice*

1. The lender will not transfer a mortgage of residential property to a body outside its company group without the consent of the borrower obtained in accordance with this statement.

2. The lender will not rely solely on any consent to the transfer of a mortgage which is contained in legal documents, unless the lender drew to the borrower's attention in the mortgage application form or by other means, before the mortgage was completed, the possibility that the mortgage might be transferred.

3. The lender may seek the borrower's *general* consent to transfer of his mortgage. For new mortgages, this will be done before the mortgage is completed. For existing mortgages on which general consent has not previously been given this will be done by individual approaches to the existing borrowers concerned, giving them a reasonable opportunity to decline to give their consent. Any transfer made under a borrower's general consent will be carried out in a way which does not cause the borrower to lose his entitlement to mortgage interest tax relief at source (MIRAS); and it will be to a body which also adheres to this Statement of Practice on the transfer of mortgages.

4. Notwithstanding any general consent which the borrower may have given, the lender will seek the borrower's *specific* consent to any transfer under which the lender would cease to:

- exercise whatever discretion in the setting of the mortgage interest rate is allowed under the mortgage; or
- determine the conduct of relations with borrowers whose mortgage payments are seriously in arrear;

unless the special conditions set out in note 2 below are met.

5. Before seeking either specific or general consent from the borrower, the lender will provide sufficient information as will enable the borrower to make an informed decision as set out in the Appendix.

*Notes*

1. This Statement of Practice is not intended to prevent:
  - transfers of mortgages *within* the lender's company group;
  - the employment of an agent to manage the mortgages, so long as control of decisions on the two key matters referred to in paragraph 4 is kept in the hands of the original lender;
  - transfers connected with the making of further advances to the borrower; or
  - the transfer of a mortgage in a way which departs from this Statement of Practice, if the lender claims to face serious business difficulties.
2. Transfers may proceed under a *general* consent if:
  - there is an agreement under which the original lender continued to conduct arrears

- cases as the agent of the transferee, and the agreement specifies that the transferee's policy on handling arrears will be identical to that of the original lender; and
- the agreement also specifies that the transferee's policy in exercising any discretion in setting of mortgage interest rates will be identical to that of the original lender.

## INFORMATION TO BORROWERS

## APPENDIX

### *General Consents*

When seeking the borrower's *general* consent to the transfer of his mortgage, as described in paragraph 3 of the Statement of Practice, the lender will provide a clear explanation of the implications of the transfer of the mortgage for the borrower.

Where there is to be or may be an arrangement under which the original lender will service the mortgage as an agent of any transferee, this explanation will confirm that the transferee's policy on the handling of arrears and setting of mortgage interest rates will be the same as the original lender's, and that the original lender will handle arrears as its agent. It will also specify a minimum length of time for which any agency agreement will be effective (subject to the satisfactory performance of the agent).

### *Specific Consents*

When seeking the borrower's *specific* consent to the transfer of his mortgage, as described in paragraph 4 of the Statement of Practice, the lender will provide the borrower with the following information:

- the name and address of the intended transferee, and of any holding company, if applicable;
- a description of the intended transferee and of his business, including details of how long he has been in operation and of his experience in the management of mortgages; and
- an explanation of the arrangements which will apply for the setting of the mortgage interest rate and for making normal repayments if the transfer takes place.

In addition, it is recommended that lenders should include with this information a statement of the intended transferee's policy in dealing with cases of arrears and default. This may, of necessity, have to be couched in general terms, and may contain a statement to the effect that cases have to be considered in the light of their individual circumstances.

## APPENDIX E

### Section 7 of the Local Government Act 1986 (S.I. 1986, No. 1028)

#### *Transfer Requires Mortgagor's Consent*

7. (1) A local authority shall not dispose of their interest as mortgagee of land without the prior written consent of the mortgagor (or, if there is more than one mortgagor, of all of them) specifying the name of the person to whom the interest is to be transferred.

(2) Consent given for the purposes of this section—

(a) may be withdrawn by notice in writing to the authority at any time before the disposal is made; and

(b) ceases to have effect if the disposal is not made within six months after it is given; and if consent is withdrawn or ceases to have effect the authority shall return to the mortgagor any document in their possession by which he gave his consent.

(3) A disposal made without the consent required by this section is void, subject to subsection (4).

(4) If the consent has been given and the local authority certify in the instrument effecting the disposal that it has not been withdrawn or ceased to have effect, the disposal is valid notwithstanding that consent has in fact been withdrawn or ceased to have effect.

(5) In such a case any person interested in the equity of redemption may, within six months of the disposal, by notice in writing served on the local authority, require the authority, the transferee and any person claiming under the transferee to undo the disposal, on such terms as may be agreed between them or determined by the court, and execute any documents and take any other steps necessary to vest back in the local authority the interest disposed of by them to the transferee.

(6) The Secretary of State may by regulations—

(a) require a local authority to give a mortgagor whose consent is sought such information as may be prescribed;

(b) prescribe the form of the document by which a mortgagor's consent is given;

(c) require a local authority making a disposal to secure that notice of the fact that the disposal has been made is given to the mortgagor; and

(d) prescribe the form of that notice and the period within which it must be given.

(7) Regulations under this section shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

(8) This section applies—

(a) to disposals on or after 24th July 1985 of a local housing authority's interest as mortgagee under a Housing Act mortgage; and

(b) to disposals on or after 1st April 1986 of a local authority's interest as mortgagee under any description of mortgage;

except, in either case, where the disposal is carried out in pursuance of a contract entered into before that date.

(9) For this purpose a "Housing Act mortgage" means a mortgage entered into (whether by the local authority in question or a predecessor in title) under—

the Small Dwellings Acquisitions Acts 1899 to 1923,

section 104 or 119 of the Housing Act 1957,

section 43 of the Housing (Financial Provisions) Act 1958,

section 100 of the Housing Act 1974, or

section 1(1)(c) of the Housing Act 1980.

## APPENDIX F

### **The Local Authorities (Disposal of Mortgages) Regulations 1986 (S.I. 1986, No. 1028)**

The Secretary of State for the Environment, in relation to England, and the Secretary of State for Wales, in relation to Wales, in exercise of the powers conferred upon them by section 7(6) of the Local Government Act 1986 and of all other powers enabling them in that behalf, hereby make the following regulations:-

#### *Citation, commencement and application*

1.—(1) These regulations may be cited as the Local Authorities (Disposal of Mortgages) Regulations 1986 and shall come into operation on 21st July 1986.

(2) These regulations apply to the disposal on or after 1st September 1986 of a local authority's interest as mortgagee of any land under any description of mortgage, other than a disposal which is carried out in pursuance of a contract entered into before 1st April 1986.

#### *Interpretation*

2. In these regulations—

“the Act” means the Local Government Act 1986;

“intended transferee” means the person to whom a local authority intend to dispose of their interest as mortgagee of any land; and

“prospective disposal” means the prospective disposal by a local authority to the intended transferee.

#### *Information to be given to mortgagors*

3. A local authority shall give to a mortgagor whose consent is sought for the purposes of section 7 of the Act, written information as to—

- (1) the name and address of the intended transferee and also, where the intended transferee is a company, the name and address of any holding company;
- (2) the effect which the prospective disposal is likely to have on—
  - (a) the rate of interest applicable to the mortgage;
  - (b) the way in which that rate is determined; and
  - (c) the places at which and the methods by which amounts payable under the mortgage may be paid;
- (3) the policy of the intended transferee with regard to mortgagors who are in arrears or default and a comparison of such policy with the policy of the local authority in relation to those matters;
- (4) the right of the mortgagor under section 7(2)(a) of the Act to withdraw his consent, the way in which consent may be withdrawn, and the fact that, to be effective, notice of the withdrawal must be given before the disposal is made;
- (5) the right of a mortgagor who does not wish to give his consent to the transfer of his mortgage to take no further action; and the fact that a mortgagor who takes no further action will not be treated as having given his consent to the transfer; and
- (6) the right of the mortgagor (and others) under section 7(5) of the Act to require the local authority (and others) to undo a disposal and the steps to be taken by a mortgagor who wishes to exercise that right.

#### *Form of consent*

4. A consent for the purposes of section 7 of the Act shall be given in the form set out in the Schedule to these regulations.

#### *Notification of disposal*

5. A local authority shall secure that notice of the fact that they have disposed of their interest as mortgagee of any land shall be given to the mortgagor no later than seven days after the date of disposal.





## APPENDIX G

### Note on the effect of the new scheme on mortgages created by standard form debenture deeds

Modern debenture deeds generally contain the following clauses relevant to land mortgages:

1. charges by way of legal mortgage over specified freehold and leasehold interests in land held by the borrower ("the company") at the date of creation of the debenture, title to which is registered at H.M. Land Registry (title numbers and descriptions of each title will be listed in a schedule to the debenture);
2. charges by way of legal mortgage over all other freehold and leasehold interests in land held by the company at the date of the debenture;
3. "first fixed charges" over all freehold or leasehold interests in land which the company may acquire after the date of the debenture;
4. a floating charge over all other presently held and future acquired property of the company;
5. a negative pledge clause, whereby the company covenants not to create any mortgage or charge in priority to or *pari passu* with any floating charge, created by the debenture;
6. a covenant by the company to deposit with the lender ("the bank") all documents of title relating to all freehold and leasehold land from time to time held by the company;
7. a covenant by the company that on demand by the bank it will execute a legal mortgage over any freehold or leasehold property acquired by it after the date of the debenture (that is, the property affected by clause 3 above);
8. an irrevocable appointment of the bank (and/or a receiver appointed by it) as attorney of the company to execute and perfect any instrument or act in order to carry out various purposes specified in the debenture;
9. a declaration of trust whereby the company declares it holds all property charged by the debenture on trust to deal with as the bank directs, and gives the bank power to appoint a new trustee in place of the company.

The effect of the charging clauses (clauses 1–4 above) under the present law and after implementation of the recommendations made in this Report, is as follows:

#### **Clause 1: Charge over specified registered titles**

##### *Present effect:*

It creates a registrable charge which, when registered, becomes a legal charge. Once the charge is registered, the bank can sell as mortgagee without further formality. (It is also protectable by notice, caution or notice of deposit.)

##### *Under new scheme:*

The charge would be expressed to be a formal land mortgage instead of a charge by way of legal mortgage, but the effect would be the same as it is as present, that is, once registered the charge would take effect as a formal land mortgage giving the bank power to sell as mortgagee; until registration it would be an informal land mortgage protectable by notice or caution.

#### **Clause 2: Charge over unspecified freehold and leasehold property presently held**

##### *Present effect:*

In the case of registered titles, the charge is not registrable (because the property is not identified) but takes effect as an equitable mortgage protectable by notice or caution, etc. In order to sell, the bank must either use the power of attorney and/or declaration of trust (clauses 8–9 above) to perfect the mortgage and then register, or it must apply to the court. If title is unregistered, the charge takes effect as a charge by way of legal mortgage, not registrable as a land charge because protected by deposit of title deeds (clause 6 above). The bank can sell without further formality.

##### *Under new scheme:*

The charge would be expressed to be a formal land mortgage. It could not be registered at

H.M. Land Registry (for the same reason as at present) so in registered land it would take effect as an informal land mortgage protectable by notice or caution. The bank would have to take the same action as at present in order to sell.

In unregistered land, it would take effect as a formal land mortgage but it would not bind third parties until registered as a land charge. As at present, however, no formality would be required for sale.

### **Clause 3: Charge over after-acquired property**

#### *Present effect:*

An equitable mortgage automatically attaches to all property as and when acquired by the company provided that the requirements of the Law of Property (Miscellaneous Provisions) Act 1989, section 2, are satisfied: the bank can then require the company to execute a legal charge over the property (see clause 7 above, although this is probably true even without such an express provision). For registered titles the bank can either protect the equitable mortgage by caution or notice as soon as it becomes aware of the acquisition of the property, or it can perfect the security (using clauses 7–9 above) by obtaining and then registering a legal charge. Even without taking either of these steps, the mortgagee can sell the property by using the power of attorney (clause 8).

In the case of unregistered titles the equitable mortgage automatically created will not be registrable as a land charge because the bank holds the title deeds (or, to be precise, it will immediately be registrable but cease to be so once the company has complied with the covenant in clause 6 above to deposit the title deeds). In order to sell, the bank must perfect the security using clauses 7–9 above, or apply to the court, or use the power of attorney in clause 8.

#### *Under new scheme:*

An informal land mortgage would automatically attach to the property as and when acquired, given that the debenture is made by deed.

The steps to be taken to protect, perfect and enforce the security would be the same as at present for registered and unregistered titles, except that in the latter case it would be necessary to register the charge as a land charge instead of relying for protection on the deposit of title deeds.

### **Clause 4: Floating charge**

#### *Present effect:*

Until crystallisation, all interests in land from time to time held by the company (other than those specifically charged by clauses 1–3 above) are subject to an equitable mortgage which floats over all such interests without specifically attaching to any of them: leaving aside the effect of a negative pledge clause (clause 5 above) the company can sell, charge or otherwise deal with any interest in land free from any charge floating over it, whether or not the floating charge is referred to on the land register or anywhere else. Once the floating charge crystallises, an equitable mortgage automatically attaches to all interests in land then held by the company (other than those specifically charged). Procedure for protection, registration and sale by the mortgagee is then the same as that applicable when an equitable mortgage automatically attaches to property by virtue of a charge over after-acquired property (as in clause 3 above).

#### *Under new proposals:*

The present position can be reproduced by providing that floating charges shall continue to exist in their present form and to operate in the same way, except that on crystallisation the charge that attaches will be an informal land mortgage. The procedure for protection, registration and mortgagee's sale will be the same as at present.

### **Other clauses**

Clauses 5 and 7–9 above will continue to perform the same function as they do at present. Clause 6 above could no longer be relied upon for protection of charges over interests in unregistered land created or arising by virtue of clauses 2–4, but clause 6 would no doubt continue to be used because of the *de facto* protection it gives.









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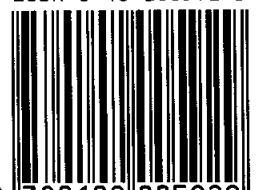
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