

YOUR UPDATE OF
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COMMERCIAL LAW

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Gary Pryce

Introduction

In vendor-purchaser disputes about the sale of an interest in land, the court has a jurisdiction to order that a purchaser who is in breach of the terms of the contract of sale should nevertheless have his deposit repaid by the vendor. The jurisdiction was recently considered in *Aribisala v St James (Grosvenor Dock) Ltd* [2008] EWHC 456 (Ch), where Floyd J concluded that the purchaser's claim for the return of a £216,000 deposit must fail. This article assesses the reasoning that led Floyd J to his conclusion and the difficulties that defaulting purchasers now face when attempting to recover their deposits.

Law of Property Act 1925, s. 49(2)

Section 49(2) provides:

"Where the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit."

Where a vendor has defaulted on its obligations under a contract of sale of an interest in land, the purchaser is entitled to seek to recover any deposit it has paid as a matter of right.

In an earlier hearing (see *Aribisala* [2007] EWHC 1694 (Ch)), the court heard the vendor's application for summary judgment which in part relied upon the validity of a term excluding the s. 49(2) jurisdiction. The Judge decided that it was not possible for parties to exclude the court's s. 49(2) jurisdiction under their contract of sale. Any contractual provision purporting to oust the court's jurisdiction is contrary to public policy and thus of no effect.

Land law: getting your deposit back

On what basis will the court exercise the s. 49(2) jurisdiction?

In practice, for much of the 20th century, it had been thought that the s. 49(2) jurisdiction could only apply where a vendor's specific performance claim either had not been made (on the basis of equitable defences available to the purchaser) or had been made and refused (on the basis of such defences).

The jurisdiction was reconsidered in *Omar v El-Wakil* [2001] EWCA Civ 1090. *Omar* was an unusual case in that Court of Appeal upheld the trial judge's finding after a 9-day trial that neither the vendor nor the purchaser was in a position to complete their obligations under the contract of sale.

Exceptional circumstances

The Court of Appeal in *Omar* held (paragraphs 35-37) that the starting-point on any application for the repayment of a deposit pursuant to s. 49(2) must be that the court would only order the repayment of a deposit to a purchaser in exceptional circumstances (not following *Universal Corporation v Five Ways Properties Ltd* [1979] 1 All ER 552). The court explained that:

- > Conveyancing is a common transaction and the giving of a deposit is a common feature of such transactions;
- > It is common knowledge that one will forfeit a deposit if one does not complete a contract for the sale of an interest in land; and
- > It is important that there should be certainty as to the consequences of paying a deposit where a purchaser fails to fulfil its obligations.

In *Tennaro Ltd v Majorarch Ltd* EWHC [2003] 2601 (Ch), Neuberger J followed the guidance in *Omar* when considering the s. 49(2) jurisdiction in respect of a more complex transaction involving the interdependent sale of three apartments. He held that special facts had to be identified by the purchaser who sought repayment of a deposit under s. 49(2),

rather than merely relying on the "classic" circumstance whereby a purchaser could not raise the funds required to complete the transaction.

In the event, it was found to be appropriate in *Tennaro* that the purchaser's deposit should be repaid in respect of two of the three apartments. In the case of both flats, the vendor had benefited from a substantial increase in the capital value of the apartments. Furthermore, in respect of one of those flats, the vendor had not taken an opportunity to sell it at a higher price than that agreed with the purchaser; it was the purchaser that had identified a third party to the vendor who was willing to purchase the flat at that higher price; the vendor's opportunity to sell to the third party would have been at about the same time as the transaction with the purchaser would have completed; and, also, the profit that would have been available to the vendor if it had taken the opportunity to sell to the third party would have been made as a result of rather than in spite of the purchaser's repudiation of the contract of sale.

Tennaro demonstrates that the exceptional circumstances or the special facts which may lead the court to order the repayment of a deposit under s. 49(2) are unlikely to arise at all frequently.

In *Aribisala* before Floyd J in March 2008, some of the "special facts" relied upon by the purchaser were that he was a Nigerian national unfamiliar with English conveyancing practice; the size of the deposit amounted to a significant proportion of the purchaser's assets; it was asserted that the fault for not completing the transaction was that of the purchaser's chosen lender; one of the two properties was being purchased for a member of the purchaser's family (his son) and thus it was not merely a commercial matter; the purchaser had sought an extension of time in advance of the date set for completion; and, the vendor had made a profit of £366,000 from the purchaser's breach on the resale of the two properties in the failed transaction.

Article continued >



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Floyd J held that the factors relied upon by the purchaser in *Aribisala* did not take the case out of the ordinary run of cases whether taken singly or cumulatively. It was emphasised that the court should also weigh in the balance that there is a need for certainty in these matters and that ordinarily the deposit is not repayable where the purchaser fails to complete the agreed transaction.

Conclusion

The courts have deliberately refrained from constructing a set of detailed guidelines to constrain judges' decisions as to when the s. 49(2) jurisdiction will be exercised in favour of a purchaser who seeks to recover his forfeited deposit notwithstanding his own breach of contract. In recent years the trend of decisions is towards allowing such claims only in highly exceptional circumstances. For example, it is highly unlikely to be sufficient that a purchaser simply could not raise the balance of funds in time for completion but had the requisite funds available shortly after the deposit had been lawfully forfeited by the vendor.

It may be necessary but not a sufficient condition that a purchaser making a s. 49(2) application is able to show that the vendor has made a substantial profit from resale and, notwithstanding the purchaser's default, the circumstances were such as still excite some sympathy for the purchaser from the court. However, pointing to a vendor's substantial profit in a rising market did not carry much if any weight in *Aribisala* – the vendor retained the £216,000 deposit and £366,000 profit on resale where the original sale price was £2.16 million.

Gary Pryce

Gary was called to the bar in 1997. His practice includes all aspects of property litigation and advisory work and related professional liability matters.

Ashe v National Westminster Bank plc: let the lenders beware!



Gerard van Tonder

Introduction

The recent decision of the Court of Appeal in *Ashe v National Westminster Bank plc* [2008] 1 WLR 710 produced a windfall for the defaulting mortgagors and has caused alarm among financial institutions.

One of the first principles in this area is that mortgagees have the right to take possession of mortgaged property "before the ink is dry on the mortgage". Courts will not readily imply a term into a legal mortgage restricting the right of the mortgagee to take possession of the property. Nevertheless, the prima facie rights of mortgagees are typically restricted by the terms of the modern mortgage contract which requires default by the mortgagor before the mortgagee can take possession.

Mortgagees also tend to delay taking possession for practical and commercial reasons. The prospect of negative equity affecting the property market as a result of the so-called 'credit crunch' may again encourage mortgagees to delay taking possession in the same way as happened in the early 1990s. The financial standing of the mortgagor is likely to affect the time scale within which the mortgagee may pursue the mortgagor for any shortfall after realising the value of the security. But the mortgagee, as is shown by the

trio of cases discussed below, must be wary that he does not wait too long before enforcing its rights, as they may otherwise become time-barred.

Recent House of Lords authorities

The House of Lords in *West Bromwich BS v Wilkinson* [2005] 1 WLR 2303 decided that the limitation period for the recovery of the shortfall was 12 years from the date when the power of sale became exercisable under s. 20(1) of the Limitation Act 1980 ('the Act') and rejected the mortgagee's suggestion that s. 20 ceased to apply once the security was realised. The House implicitly overruled the decision of the Court of Appeal in *Hopkinson v Tupper*, (unreported, 30 January 1997) that it was arguable that the period for claiming any shortfall was 6 years as a simple contractual claim from the date on which the mortgagee had taken possession.

The later decision of the House of Lords in *Bradford & Bingley plc v Rashid* [2006] 1 WLR 2066 again concerned the issue whether the mortgagee's claim for the shortfall was statute-barred. The property was sold by the mortgagee in October 1991 (under a right that had become exercisable some time previously), but the claim for the shortfall was not commenced until June 2003. The delay was, at least partly, due to the fact that the mortgagee could not trace the mortgagor for several years. Once he had been traced the mortgagee's solicitors wrote to him and invited him to make an offer in respect of the shortfall. A legal advice centre wrote on his behalf to the mortgagee's solicitors saying that "at present he is not in a financial position to repay the outstanding balance owed to you" but that he would do so once his financial position improved. A further letter was written on the mortgagor's behalf by the advice centre offering to "pay approximately £500 towards the outstanding



THE PROSPECT OF NEGATIVE EQUITY AFFECTING THE PROPERTY MARKET AS A RESULT OF THE SO-CALLED 'CREDIT CRUNCH' MAY AGAIN ENCOURAGE MORTGAGEES TO DELAY TAKING POSSESSION IN THE SAME WAY AS HAPPENED IN THE EARLY 1990s.



amount as a final settlement". Neither letter was expressly marked 'without prejudice'.

No payment was made and the claim was commenced for the shortfall. The only defence to the claim was that it was statute-barred by s. 20(1) for the debt and s. 20(5) in respect of the interest. The House decided that the letters were not part of an attempt by the mortgagor to compromise actual or impending litigation and so were not protected by the "without prejudice" privilege. The fortunate mortgagee was accordingly able to rely on the mortgagor's acknowledgements under s. 29(5) of the Act to extend the limitation period so that the claim was brought in time.

Ashe v National Westminster Bank plc

Ashe v National Westminster Bank plc is a decision of the Court of Appeal. The facts were that in 1989 the mortgagors, Mr and Mrs Babai, granted a second charge over their home to the mortgagee to secure Mr Babai's business borrowing. The charge was an 'all moneys' charge and it did not restrict the mortgagee's right to possession until the mortgagors were in default. Mr Babai defaulted on the business borrowing. The mortgagee made formal demands for repayment of the sums secured by the charge in 1992, but took no proceedings or other steps to enforce its right to possession or otherwise to protect its legal position. Negotiations followed between the parties about instalment payments and some payments were made, with the last being made on 4 January 1993.

Mr Babai was made bankrupt on 22 March 1993. Although the mortgagee wrote to Mr Babai on a few occasions over the years reminding him that he remained liable to it and indicating that it would be willing to accept instalment payments over a period of 10 years, no legal proceedings were issued by the mortgagee to enforce its rights against the mortgagors or the property. Mr Babai's trustee in bankruptcy, Mr Ashe, brought proceedings on 14 September 2006 claiming (by an amendment) a declaration that the mortgagee's charge over the

property had been extinguished. The Judge at first instance declared that the charge had been extinguished by operation of ss. 15 and 17 of the Act.

Several public interest points were made at the appeal on behalf of the mortgagee. The general theme of the points was that the effect of the decision of the Judge would be to oblige mortgagees to bring possession proceedings to prevent their security rights from becoming statute-barred. Mummery LJ (who delivered the only substantive judgment) described the practical implications of the decision as being "in danger of being exaggerated" and of being of no assistance to the court in interpreting "lawyers' law about mortgages, real property and limitation of actions, which has taken about 400 years to evolve."

The mortgagee conceded that its right to bring a claim against Mr Babai for the mortgage debt was statute-barred (even if the cause of action was taken back to the date of the last payment in 1993). But it contended that its right to bring an action for possession against Mr and Mrs Babai was not statute-barred, as their possession of the property must have been with the express or implied consent of the mortgagee and that it was accordingly not "adverse possession" as required by paragraph 8 in Part I of Schedule I to the Act. There was, in fact, no evidence that Mr and Mrs Babai had ever sought the consent of the mortgagee to remain in the property. The ingenious argument on behalf of the mortgagee was that because it was entitled as of right to possession of the property when the legal charge was granted in 1989, Mr and Mrs Babai were therefore in possession of the property with its implied permission.

Mummery LJ rejected the argument. He held that it did not necessarily follow from the mortgagee's non-enforcement of its right to possession, or its lack of objection to, or tolerance of Mr and Mrs Babai's possession of the property that it was impliedly granting them permission to remain in possession of the property. He analysed the true nature of the

transaction giving rise to the legal charge and concluded that Mr and Mrs Babai's continued possession of the property after they had given the charge was referable to their proprietary interest in the property as the registered owners and not to any implied permission from the mortgagee. The judge relied on the meaning given to "adverse possession" by the House of Lords in *J A Pye (Oxford) v Graham* [2003] 1 AC 419 in holding that Mr and Mrs Babai had been in adverse possession of the property on the basis that the *Pye* case is of general application to actions for the recovery of land. The judge accepted that it might be an unpleasant surprise for other mortgagees to discover that their mortgagors are actually in adverse possession of the mortgaged properties. The appeal was accordingly dismissed.

Conclusion

If, as the doomsayers have been predicting, we are again to be faced with negative equity affecting many homes in the United Kingdom, mortgagees may be tempted to wait out the storm in the hope that property values improve. The mortgage cases discussed above, which had their genesis in the last property slump, clearly show that mortgagees would be well advised to resist this temptation. The practical advice to mortgagees is that they will need to obtain payments or clear acknowledgments of liability from their mortgagors to prevent claims becoming statute-barred.

Gerard van Tonder

Gerard was called to the Bar in 1990. He has a general Chancery practice, with particular emphasis on property, commercial and professional negligence matters. He also has a distinct specialism in costs disputes.



Kenneth Munro

Introduction

Everyone with a practice involving enfranchisement, whether of houses under the Leasehold Reform Act 1967 or of flats under the Leasehold Housing and Urban Redevelopment Act 1993, will have heard of the decision of the Lands Tribunal in *Cadogan v Sportelli* and the Court of Appeal's dismissal of appeals by both the landlords and the tenants ([2007] EWCA Civ 1042).

There were two issues in the Court of Appeal:

- (i) the deferment rate to be applied to valuing the reversion; and
- (ii) whether the value of the reversion included "hope value", ie the hope of doing a deal with the tenant or the tenant's successor in title at some date after the valuation date.

The deferment rate issue had been exercising valuers since before the 2004 decision of the Lands Tribunal in *Blendcrown v The Church Commissioners* in which the Lands Tribunal first recognised that deferment rates commonly applied for over 20 years before then were too high.

The importance of the decision in *Sportelli* was reinforced by the Lands Tribunal's gathering together of a number of appeals involving a house, individual lease extensions and collective enfranchisements of blocks of flats, with the intention of giving guidance to practitioners and Leasehold Valuation Tribunals. It was clear before and during the hearing that the Lands Tribunal wanted to give guidance on enfranchisement valuations that would limit the number of disputed claims (and appeals) for a goodly period of time.

The Court of Appeal approved the right of the Lands Tribunal to give general guidance. It rejected a tenant's appeal against the choice of deferment rate, 4.75% for houses and 5% for flats. It was clearly concerned that there might be evidence to justify different rates outside 'prime central London' ('PCL') and left open the possibility of different deferment rates in different parts of the country. The result is that for reversions of between 20 years and something over 70 years (effectively the length of reversions in issue in *Sportelli*) the deferment rate is fixed for some

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indeterminate period of time unless there is credible evidence showing that the rate should be different.

The Lands Tribunal had decided that although hope value existed as part of the value of a reversion it was irrecoverable under the statutory valuations. The Court of Appeal agreed. Although strictly obiter (because there was no appeal involving a house), the Court opined that it was also irrecoverable under the 1967 Act.

Whither now?

A few weeks after the decision in *Sportelli* the Court of Appeal had to rule on two appeals involving hope value and houses (in cases generally known as *Cadogan v Pitts & Wang*). Given the *Sportelli* decision, the result was inevitable: the Court of Appeal dismissed the Landlords' appeal. The Landlords petitioned the House of Lords for leave to appeal in both *Sportelli* and *Cadogan v Pitts & Wang*. The House of Lords refused the petition for leave in *Sportelli*. Most unusually the Appellate Committee then changed its mind, and indicated that it was minded to grant leave to appeal the hope value issue in *Sportelli*. Despite strong objections from one of the respondents the House has now also reversed its original refusal and has granted leave to appeal on both of the points argued before the Court of Appeal in *Sportelli*. It has also granted leave to petition in *Cadogan v Pitts & Wang*. Hope value is therefore very much back on the agenda.

The issue of the correct deferment rate is even more difficult. Unsurprisingly, outside London, landlords have used *Sportelli* to support what are often very substantial drops in the deferment rate and equally substantial increases in the premium or price payable. The reactions of LVTs outside London has been mixed. Some have followed loyally the *Sportelli* guidance. Some have looked for evidence to justify a departure from it, with mixed results. Some seem to have come perilously close to ignoring *Sportelli* altogether. Where LVTs outside London have found evidence to justify a departure from *Sportelli*, the evidence appears less than convincing.

In London there have been three main debates. They are:

- > can tenants' valuers show that there is evidence justifying a departure from *Sportelli*?
- > what is PCL?
- > what, if any, adjustment should be made where the reversion has less than 20 years unexpired?

The results have been mixed. With some exceptions the London LVTs have followed *Sportelli*. But again, where they have departed from *Sportelli* the evidence and reasoning have been less than convincing.

What is PCL is important because the Court of Appeal did not define it. There is no common definition, though FPD Savills research department's definition is probably the most widely used. The Lands Tribunal had to revisit the subject in a claim relating to a large block of flats in Hampstead (*Hildron v Greenhill*), concluding that Hampstead was not within PCL but rejecting the tenants' evidence in support of a deferment rate of more than 5%. In the latest Lands Tribunal appeal, concerning a block of flats in Morden, no doubt pleasant but not PCL, the Lands Tribunal refused to budge from a deferment rate of 5% (*Deajan v The Holt*).

The adjustment, if any, to be made where the reversion has less than 20 years unexpired has been equally problematic. There is now another series of appeals waiting for hearing dates in the Lands Tribunal. The adjustment is one of the issues in those appeals. Like *Sportelli*, there will be financial evidence as well as evidence from property valuers.

In *Sportelli*, as in *Arbib v Cadogan* [2006] RVR 387, the Lands Tribunal constructed the deferment rate by taking a risk free rate adding a risk premium and deducting an assumed anticipated real growth rate from valuation date to term. It assumed, on limited evidence, that over time the same real growth rate will apply across the country. One of the central issues in the next round of appeals will be whether that assumption was correct. Another will be whether the Lands Tribunal was right to assume that there might be a different growth rate for unexpired terms of less than 20 years. Inevitably, consideration of anticipated growth means that the risk premium will have to be revisited. The end result may be a lower deferment rate than that adopted by the Lands Tribunal in *Sportelli*.

Conclusion

Sportelli answered a number of questions. It left some unanswered. It raised yet others. It can only be hoped that the House of Lords and the Lands Tribunal provide the answers sooner rather than later.

Kenneth Munro

Kenneth is recommended as a leading junior for real estate litigation in the 2008 edition of Chambers & Partners, where he is described as having a "sharp mind and user-friendly approach to clients." Kenneth was counsel for the Church Commissioners in *Blendcrown*, for the landlord in *Arbib*, for two of the three landlords in *Sportelli* and for the landlord in *Hildron*.

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