Property Litigation Blog: "Not-So-Overriding" Interests

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As part of a regular series of articles from *Enterprise Chambers*, *Kavan Gunaratna* considers the statutory schemes and case law governing overriding interests.

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Contents

Practitioners will be familiar with the statutory scheme by which unregistered interests can override registered dispositions of a legal estate. The most memorable of these are the interests of persons in actual occupation of land, as regulated by section 29 and paragraph 2 of Schedule 3 to the Land Registration Act 2002 (LRA 2002), and formerly by section 70(1)(g) of the Land Registration Act 1925 (LRA 1925).

Those provisions are what prompt the daily carrying out of inquiries and inspections on land nationwide on behalf of purchasers and banks who are to take a registered disposition by a transfer or charge. They likewise prompt the daily signing of waiver or postponement forms by anyone in, or about to go into, occupation of the property. The statutory scheme thereby seeks to strike a fair balance between the interests of actual occupiers in maintaining their priority, and the interests of purchasers and lenders in taking free of any such interests, on the usual proviso that the latter (or their legal advisors) have done their 'homework' in carrying out such inquiries and obtaining such waivers.

However, the statutory scheme does not exclusively hold this balance. Even if the purchaser or lender has failed to do their homework and failed to spot what is ostensibly an overriding interest, the courts have developed principles on which such interests will fail to bind the purchaser or bank, despite the apparent wording of those provisions of the LRA 2002. These include the so-called *Brocklesby* principle, which has recently been applied in a highly striking way and extended further than ever-before by the Court of Appeal in *Wishart v Credit and Mercantile plc [2015] EWCA Civ 655* (see, *Legal update, Whether an occupier in actual occupation was bound by a charge where agent acted on its behalf as owner (Court of Appeal) (www.practicallaw.com/6-617-2657)*).

The statutory scheme

Section 29 of the LRA 2002 sets out the effect of registration (e.g. of a purchaser or a lender, as the new proprietor of the freehold or leasehold estate, or of a legal charge over it):

> "(1) If a registrable disposition of a registered estate is made for valuable consideration, completion of the disposition by registration has the effect of postponing to the interest under the disposition any interest affecting the estate immediately before the disposition **whose priority is not protected** at the time of registration. (2) For the purposes of subsection (1), **the priority of an interest is protected** - in any case, **if the interest** - ... (ii) **falls within** any of the paragraphs of **Schedule 3**...".

(Emphasis added throughout.)

Section 70(1)(g) of the LRA 1925 (the predecessor to the LRA 2002) and paragraph 2(b) of Schedule 3 to the LRA 2002 then established a statutory scheme by which the purchaser or bank would have protection from unregistered rights of persons in actual occupation, provided that the disponee did their homework in terms of inspecting the property and conducting inquiries with due care and attention, without such rights being disclosed – i.e. against "*an interest of a person of whom inquiry was made* before the disposition and *who failed to disclose the right* when he could reasonably have been expected to do so".

A case law twist and the Brocklesby principle

In general

One might ordinarily think that, under those same statutory provisions, a purchaser or bank would then be bound by the rights of any such actual occupiers if they failed to do their homework as envisaged by paragraph 2(b) of Schedule 3 to the LRA 2002. In this context, the familiar example is where:

- Mr X is the registered proprietor of freehold or leasehold property.
- Mr X holds the property on trust (in some form) for Ms Y as a beneficial owner with a right to occupy the property under the trust, and Ms Y is in actual occupation at all material times.
- Mr X, at some point after first acquiring the property, grants a mortgage to Bank Z as security for a loan advance made in his name.
- Bank Z seeks possession of the property when Mr X defaults in repayment, but Ms Y claims an overriding interest on the basis of her actual occupation, which the bank failed to ascertain at the time of the mortgage.

However, in certain circumstances, case law will supply a twist to the outcome ordinarily expected under paragraph 2(b): even if the bank failed to carry out inquiries at the relevant time, it may not be bound by the occupier’s interest. In this regard, case law has developed based on notions of the occupier's consent to the disposition and/or under a broad principle 'akin to an estoppel', in what has more recently been described as the *Brocklesby* principle.

Brocklesby

In *George Jobson Brocklesby v Temperance Permanent Building Society and others [1895] AC 173*, the apellant, Mr Brocklesby, had various real property interests and authorised his son to obtain his title deeds and to raise a loan of £2,250 using them as security. The son instead fraudulently obtained a mortgage advance of £3,500 from one bank and pocketed the difference, before later remortgaging with the Temperance Building Society. The son absconded and Mr Brocklesby discovered the fraud and sought a declaration that he was only bound by the mortgage to the extent of £2,250. However, the judge at first instance, the Court of Appeal and the House of Lords all held that Mr Brocklesby was bound by the mortgage for the full amount, despite the son having borrowed more than he was authorised. The House of Lords followed *Perry Herrick v Attwood (2 De G. and J. 21)* and applied the principle "*...well established in equity: that where a person has thus been intrusted with the possession of title-deeds with authority to raise money upon them, the owner of the deeds cannot take advantage of any limitation in point of amount which he placed upon the authority to raise money as against a lender who had no notice of it*".

Rimmer v Webster

In *Rimmer v Webster [1902] 2 Ch 163* the claimant, Mr Rimmer, held a bond which he formally transferred to a stockbroker with instructions to sell it. The stockbroker instead fraudulently obtained a loan from Mr Webster using the bond as security, and then absconded with the loan proceeds. Mr Rimmer sought to reclaim the bond free of Mr Webster's mortgage. Farwell J rejected Mr Rimmer's claim, citing *Perry Herrick* and *Brocklesby*. He held that, if the owner entrusted his title deeds to another:

> "with an intention that the person to whom the indicia of title are intrusted should deal with them... the case then falls to be decided in accordance with the principles governing...authority given by a principal to an agent...". "...the particular authority proved...is necessary in order to make the case one to which the principles of agency apply at all; but when that is once proved, and the owner is found to have given the vendor or borrower the means of representing himself as the beneficial owner, the case forms one of actual authority apparently equivalent to absolute ownership, and involving the right to deal with the property as owner, and any limitations on this generality must be proven to have been brought to the knowledge of the purchaser or mortgagee...".

Paddington Building Society v Mendelsohn

In *Paddington Building Society v Mendelsohn (1985) 50 P and CR 244*, a mother and son agreed to buy a flat together which was acquired in the son's sole name. The mother provided some of the deposit funds with the balance funded by a mortgage advance from the Building Society to the son. Subsequent possession proceedings by the Society were defended by the mother on the grounds that she had an overriding interest. However the Court of Appeal rejected that claim: "*Since the mother knew and intended that the mortgage was to be granted to the society and that without the mortgage the flat in which she claims a beneficial interest could not have been acquired, the only possible intention to impute to the parties is an intention that the mother's rights were to be subject to the rights of the society....*".

Abbey National Building Society v Cann

In *Abbey National Building Society v Cann [1990] UKHL 3*, Mr Cann acquired a house in his sole name, partly with the proceeds of sale of a property in which his mother had previously been living, and largely with the benefit of an acquisition mortgage from Abbey National. His mother had a beneficial interest or a right to

occupy the house under an estoppel and occupied the property from the day the purchase completed. Mr Cann borrowed further monies under the mortgage without Mrs Cann's knowledge. He then defaulted, leading to the Society's claim for possession. He had falsely told Abbey National from the outset that the house was being bought for his sole occupation, and they knew nothing of Mrs Cann's interest.

The Court of Appeal rejected Mrs Cann's claim to have an overriding interest because:

> "Mrs Cann did not know of any mortgage...She knew, however, that the net proceeds of sale of [her previous home]...would be insufficient to cover the purchase of 7 Hill View. She left it to George Cann to raise the balance. If he had raised that balance and no more by the mortgage to [Abbey National], that would have been within his authority and Mrs Cann's right would have been subject to the rights of [Abbey National]. In fact George Cann, in fraud of Mrs Cann, raised much more, but [Abbey National] did not know of any limitation on his capacity to deal with No. 7. It follows...that [the Society] is entitled to priority over Mrs Cann's rights for the full amount of its original £25,000 advance. (Compare *Perry Herrick v Attwood* and *Brocklesby v Temperance Building Society*.)"

The House of Lords rejected Mrs Cann's appeal. The ratio of their decision was that Mrs Cann had not in fact been in actual occupation of the house before or at the time of the mortgage (which was taken to occur simultaneously with completion of the purchase). However, in obiter dicta, they also approved the reasoning of the Court of Appeal. Lord Oliver recorded that:

> "Dillon LJ (with whom, on this point, the other two members of the court agreed) inferred that "she left it to George Cann to raise the balance"...from which he further inferred that George Cann had authority to raise that sum from [Abbey National, by mortgage]... in my judgment the court was entitled to draw the inference that it did draw. If that is right, it follows that George Cann was permitted by her to raise money on the security of the property without any limitation on his authority being communicated to the society. She is not, therefore, in a position to complain, as against the lender, that too much was raised and even if, contrary to the view which I have formed, she had been able to establish an interest in the property which would otherwise prevail against the society, the circumstances to which I have alluded would preclude her from relying upon it as prevailing over the society's interest for the reasons given in the judgment of Dillon LJ...".

Thompson v Foy

In *Thompson v Foy [2010] 1 P and CR 16*, Mrs Thompson had transferred property to her daughter, Mrs Foy, who had mortgaged it to raise funds, some of which Mrs Thompson expected to be paid to her. Mrs Thompson later claimed that she was entitled to set aside the transfer on grounds of undue influence and that her right to do so was an overriding interest against the bank due to her actual occupation at the time of the mortgage, which the bank failed to note. Lewison J rejected the undue influence claim, but considered in any event that Mrs Thompson would have no overriding interest under the Brocklesby principle:

> "One thing is clear from start to finish in this case. Money was always going to be raised on mortgage. Mrs Thompson knew and understood that and wanted it to happen. She wanted it to happen because she knew that without a mortgage she would not receive her £200,000. She executed the assent transferring the legal title to Mrs Foy in order to enable the money to be raised by the grant of a mortgage. In those circumstances I would have held that Mrs Thompson

> was precluded from relying as against [the bank] upon any right to set aside the assent for undue influence."

Bank of Scotland v Hussain and Qutb

In *Bank of Scotland v Hussain and Qutb [2010] EWHC 2812 (Ch)*, Newey J reviewed the modern authorities, noting that there was room for argument about the basis for the principle which emerges, which ranged between imputed intention, agency principles, and something akin to proprietary estoppel:

> "In some cases, the person claiming not to be bound by a mortgage can fairly be taken to have given the legal owner actual authority to enter into it or to have ratified it. Where that is so, the mortgage may be binding on ordinary agency principles. In other cases, the principle may perhaps best be explained as a species of, or akin to, proprietary estoppel".

Although Mrs Qutb claimed an overriding interest under section 70(1)(g) of the LRA 1925, Newey J held that she:

> "will have (or ought reasonably to have) appreciated that Mr Hussain was going to mortgage [the property]... [and] Almost all of the money advanced by the Bank found its way...into Mrs Qutb's bank account. It thus accrued to her benefit...[She] argued that there could be no estoppel because [she] had no direct relationship with the Bank...however, the principle established by the authorities is capable of applying even where there was no direct relationship between the person asserting rights and the mortgagee... In all the circumstances, I have concluded that the principle established by the Paddington line of authorities is applicable and that Mrs Qutb is accordingly bound by the Charge."

Stretching the Brocklesby principle: Wishart v Credit and Mercantile plc

In *Wishart v Credit and Mercantile plc [2015] EWCA Civ 655*, both at first instance and on appeal , the so-called *Brocklesby* principle was invoked to reject Mr Wishart's claim to an overriding interest over the bank's charge. However, the application of the principle to the facts of the case is particularly striking and it represents the most extreme extension of the principle to-date.

On 11 May 2010, a residential property called "Dalhanna" was purchased, with the legal title being registered in June 2010 in the name of a company called Kaymuu Limited, controlled by a Mr Sami Muduroglu. The property was in fact acquired on a constructive trust for Mr Wishart as its beneficial owner, 'Sami' having been a close friend and business partner of Mr Wishart. On 14 May 2010, Mr Wishart moved into the property and thereafter remained in actual occupation of it with his partner at all material times. Unbeknown to Mr Wishart, Sami had in fact applied to C and M for a loan which Sami proposed to secure against the property held in Kaymuu's name. On 19 May 2010, C and M's surveyor visited the property but failed to appreciate Mr Wishart's occupation, which would have been obvious on a reasonably careful inspection. On 22 June 2010, C and M advanced £500,000 to Kaymuu in return for a mortgage over the property which was later registered. Sami took the money, lost it all gambling, absconded and was declared bankrupt. Mr Wishart only learned about the mortgage in September 2010 when Kaymuu had defaulted on its repayments to C and M. He claimed that his beneficial ownership of the property was an overriding interest which was not subject to the mortgage so that when the property came to be sold, the net proceeds were payable to him.

Mr Wishart apparently knew nothing about the mortgage; he had no prior contact with C and M, he did not instruct Sami or Kaymuu to sell or mortgage the property for him; the mortgage was not necessary for the purchase; and he derived no benefit from it. Furthermore, C and M would prima facie have had a claim against its surveyor who failed to spot Mr Wishart's obvious occupation, so that the prejudice to the bank would have been substantially lessened if Mr Wishart's claim succeeded.

However, the Court of Appeal held that Mr Wishart was precluded from claiming an overriding interest by reference to the *Brocklesby* principle:

> "The Brocklesby principle is not based on actual authority given to the agent, but rather on a combination of factors: actual authority given by the owner of an asset to a person authorised to deal with it in some way on his behalf; where the owner has furnished the agent with the means of holding himself out to a purchaser or lender as the owner of the asset or as having the full authority of the owner to deal with it; together with an omission by the owner to bring to the attention of a person dealing with the agent any limitation that exists as to the extent of the actual authority of the agent. This combination of factors creates a situation in which it is fair, as between the owner of the asset and the innocent purchaser or lender, that the owner should bear the risk of fraud on the part of the agent whom he has set in motion and provided (albeit unwittingly) with the means of perpetrating the fraud".

> "...Mr Wishart left the acquisition of Dalhanna completely in the hands of Sami. Mr Wishart gave Sami authority to make whatever arrangement he saw fit to acquire Dalhanna, so long as the net result was that Mr Wishart would have the beneficial ownership of it free of any mortgage. As the judge said, Mr Wishart gave Sami "free rein" to make the arrangements for the acquisition ([162]). Clearly, Sami acted outside the limits of his authority by arranging for the grant of the mortgage over Dalhanna to C and M, but C and M was not on notice of any such restriction on his authority. Mr Wishart exercised no supervisory function whatever in relation to what Sami might do to effect the transaction to acquire Dalhanna. He did not ask to inspect or countersign the contract of purchase. He did not contact the vendor to explain his interest in the acquisition; nor did he seek to enter any note of his interest on the register at the time of the acquisition. He did not arrange...to explain to anyone that the money which was being provided for Sami to complete the purchase of Dalhanna was to be regarded as Mr Wishart's money. In this way, in practical terms, Mr Wishart furnished Sami with the means to hold himself out as the true beneficial purchaser of Dalhanna, and hence as the legal and beneficial owner of the property for the purposes of borrowing money from C and M against the mortgage in its favour."

This is a remarkable extension of the so-called *Brocklesby* principle. In the cases leading up to *Wishart*, the owner seeking to claim priority over the mortgage had instructed or (expressly or impliedly) authorised the person who granted the charge to mortgage the property, or at least (in *Rimmer v Webster*) instructed him to sell it. Mr Wishart's case seemed naturally distinguishable given the absence of any such authority to sell or mortgage the property, but the court concluded that the case was directly analogous to *Cann*.

It might be thought that the court's approach in *Wishart* was (at least subconsciously) influenced by the suspicious or opaque nature of much of the factual background. For example, the court noted that Mr Wishart had been convicted of serious criminal charges and sentenced to six and a half years in prison; that he had been a very close friend or associate of Sami; and that Sami had been disqualified from acting as a company director for five years and committed a number of frauds. However, the principles discussed by the court will of course be subject to wider application.

Perhaps most striking is the conclusion that the onus was effectively on Mr Wishart to either register his interest at the Land Registry, or mention his beneficial ownership to the surveyor sent in by C and M, or to take other steps to be more actively involved in the purchase or generally supervise his trustee. It is respectfully suggested that there is a real tension between such sentiments, and those expressed by previous courts when formulating or considering the *Brocklesby* principle. For example, in *Brocklesby* itself, Lord Herschell LC said:

> "There can be no doubt that the mere possession of deeds of title...will not of itself validate a security given by the person to whom the possession of the deeds has been committed where there was no authority given to him to use the deeds as security. That is old law, and was distinctly laid down in the case of *Martinez v Cooper 2 Russ. 198*."

In *Rimmer v Webster*, Farwell J said:

> "It is, indeed, plain that a man may in many cases intrust another with all the indicia of ownership, including the legal title, and yet not deprive himself of his equitable rights... The principle upon which those cases are founded is stated by Lord Cairns, so far as relevant to the present case, in *Shropshire Union Railways and Canal Co. v. Beg. L.R. 7 H.L. 507, 509*: “My Lords, in the first place, the arguments at your Lordships' bar on behalf of the respondent appeared to me to go almost to this, that whenever you have an equitable owner who is the absolute owner, that is to say, entitled to the whole equitable interest, such a person ought not to have a trustee at all holding the indicia of legal ownership; or, if he chooses, for his own purpose, to have such a trustee, he must be in danger of suffering for every, act of improper conduct by that trustee...My Lords, that is a very serious proposition. It goes... to say that, whereas there is a large, well-known, recognised, and admitted system of trusts in this country, that system of trusts is to be cut down... [and that] the equitable owner is under some measure of obligation with regard to his duty of watching his trustee... I find no authority for such a proposition, and I feel satisfied that your Lordships will not be disposed to introduce, for the first time, that as a rule of law."

When read as a whole, Farwell J's judgment also makes plain his view that the *Brocklesby* principles were only engaged because the beneficial owner had a proven or admitted intention that the assets be realised ('deal with'), albeit by sale rather than mortgage.

It is not known whether those particular passages were cited to the court in *Wishart*. They are not discussed in the judgments, which appear to only replicate the very limited quotes from *Rimmer* that appear in *Thompson v Foy*; nor do they appear to consider the *Brocklesby* case itself. It may therefore be open to question (at least at the level of the Court of Appeal and above) whether the decision in *Wishart* represents a sustainable extension of the *Brocklesby* doctrine, at least as conventionally recognised.

For the time being, however, the effect of *Wishart* is to significantly broaden the types of circumstances in which lenders and purchasers may deny that an interest is overriding, even where they have failed to protect themselves by inquiry and inspection under paragraph 2 of Schedule 3 to the LRA 2002.

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