

Harsh justice

Can an equitable interest in a house take priority over a legal charge? [Nicholas Asprey](#) reports

IN BRIEF

► Whether an equitable interest takes priority over a legal charge is governed by s 29(1) of the Land Registration Act 2002 and the law relating to proprietary estoppel.

► In *Scott*, the vendor's equitable interest, based on a promise made before the sale, could not take effect before completion, and therefore could not have priority over the legal charge.

Take a simple case in which an elderly lady living on her own wishes to raise money for her old age. She owns the house in which she lives. A friend suggests that she sells the house to him and he will rent it back to her at a discounted rent. He assures her that she can remain living there for as long as she likes. The sale price is reduced accordingly.

The purchaser applies for a mortgage loan. He instructs solicitors, who also act for the lender. Other solicitors act for the vendor. The lender is told that the house is being purchased subject to an assured shorthold tenancy (AST) of six month's duration, but is not told about the promise made to the vendor that she can live there for as long as she likes. The draft contract makes no mention of this promise either.

Contracts are exchanged, the vendor executes a transfer in favour of the purchaser and the purchaser executes the AST in favour of the vendor. The lender transfers the loan money to the purchaser's solicitors and the purchaser executes a legal charge.

Completion takes place in the usual way. The purchaser is registered as the proprietor and the lender is registered as owner of the legal charge. The purchaser then defaults on the loan instalments and the lender applies for possession.

The basic question

These were the essential facts in *Scott v Southern Pacific Mortgages Ltd* [2014] UKSC 52. The issue was whether the vendor, Mrs Scott, had an equitable interest in the house, based on the promise that she could live there for as long as she liked, which took priority over the legal charge. The Supreme Court, relying on the decision of the House of Lords in *Abbey National Building Society v Cann* [1991] 1 AC 56 held that she did not.

This decision was harsh because Mrs Scott had apparently been tricked into

selling her house. But the mortgage lender was also tricked into making the loan. Despite its severity, the decision is undoubtedly correct, but an essential point seems to have been overlooked.

The issue was one of priority. Did the vendor acquire an equitable interest in the house, based on the promise that she could stay there as long as she liked, which took priority over the legal charge, or did the legal charge take priority over her equitable interest? This question is governed by provisions of the Land Registration Act 2002 (LRA 2002); but the answer depends also on the law relating to proprietary estoppel.

The statutory provisions

Section 29(1) of LRA 2002 provides that if a registrable disposition 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". A legal charge is a disposition which is required to be completed by registration.

Whether an interest is "protected" for this purpose is determined by s 29(2). This provides that the priority of an interest is protected: "(a) in any case, if the interest—(ii) falls within any of the paragraphs of Sch 3". Para 2 of Sch 3 reads: "An interest belonging at the time of the disposition to a person in actual occupation, so far as relating to land of which he is in actual occupation."

In *Scott* the vendor was at all material times in actual occupation. The question therefore was whether she had an "interest affecting the estate" and whether that interest arose "immediately before" the grant of the legal charge. If she did, her interest would be "protected" and registration of the legal charge would take effect subject to that interest. But if she did not, the legal charge would take priority over her interest and the lender would be entitled to possession.

Section 132(3)(b) of LRA 2002 provides that references to an "interest affecting the estate" are to an adverse right affecting the title to the estate; and s 116 declares for the avoidance of doubt that in relation to registered land an equity by estoppel has

effect "from the time the equity arises" as an interest capable of binding successors in title, subject to the rules about the effect of dispositions on priority. This makes it clear that a right which arises after detrimental reliance has effect as an interest in the land even before it is given effect by the court. But precisely when that interest arises depends on the general law.

Proprietary estoppel

The promise made to the vendor was that if she sold the house to the purchaser she could stay there for as long as she liked. This is a paradigm example of proprietary estoppel, which conferred on the vendor an equitable interest in the property. But since the issue was one of priority it was crucial to determine when that interest arose. Did it arise at exchange of contracts or on completion of the sale? There can be only one possible answer to this question.

Between exchange of contracts and completion the vendor was entitled to remain in possession not by virtue of an equitable estoppel based on the promise but under the sale contract. She retained the freehold estate and her obligation under the contract was to transfer the freehold and give vacant possession to the purchaser on completion. Any attempt to evict her prior to completion would be met by a defence based not on proprietary estoppel but on the sale contract.

The basis of proprietary estoppel is that equity "will prevent a person from insisting on his strict legal rights—whether arising under a contract, or on his title deeds, or by statute—when it would be inequitable for him to do so having regard to the dealings which have taken place between the parties" (per Lord Denning in *Crabb v Arun District Council* [1976] Ch 179, [1975] 3 All ER 865). Thus, pending completion of the sale it is inconceivable that an equity could arise to prevent the purchaser from exercising a legal right to possession because he had no such right at that stage. The vendor was entitled to remain in possession until completion and there was no need for equity to intervene.

In *Scott*, it was contended by the vendor that from the moment of exchange of contracts she had an equity in the property, based on the promise, which was separate from and in addition to her registered freehold estate. She contended that the purchaser could grant her an equitable interest before he had acquired the legal estate. This argument was dismissed on its merits and the court held that the vendor only acquired a personal right and not a proprietary interest at that stage: but in reality, the argument was fundamentally misconceived.

All that happened on exchange of contracts was that the vendor agreed to sell the house to the purchaser *at completion*, subject to a right for her to stay there as long as she liked. The purchaser did not confer, or purport to confer, any right or interest on the vendor which would take effect prior to completion. Accordingly, her equitable interest in the property could not arise before completion.

Completion

At completion, the purchaser paid the balance of the purchase price to the vendor, using the loan money, and the vendor transferred the freehold estate to him; and he handed the executed legal charge to the lender. The purchaser was now estopped from obtaining possession and the vendor acquired an equitable interest in the property. The question is whether her equitable interest took priority over the lender's charge.

Again there is only one possible answer to this question and it is provided by s 29(1) of LRA 2002. This shows that the vendor's equitable interest would only take priority if it existed "immediately before" the grant of the legal charge.

As explained already, that interest

could not arise before completion; but on completion it arose simultaneously with the transfer. In effect, the freehold was transferred to the purchaser subject to the vendor's interest. Moreover, when a property is purchased with a mortgage loan, the transfer and the legal charge also take effect simultaneously. This was decided in *Cann*. Accordingly, the vendor's interest could not have taken effect "immediately before" the legal charge, and under s 29(1) the legal charge took priority.

The lender sought to distinguish *Cann* on the ground that Mrs Cann did not have an equitable interest prior to completion, whereas in *Scott* the purchaser promised the vendor that she could stay in the house for as long as she liked and she had acted on that promise by exchanging contracts; it was contended that this so-called "estoppel" was "fed" by the acquisition of the legal estate. The court held, as in *Cann*, that there was no interval of time between the transfer and the grant of the legal charge during which the estoppel could be "fed" by acquisition of the legal estate; but on a true analysis there was no estoppel at all prior to completion and therefore no estoppel to be "fed".

Conclusion

The decision in *Scott* is undoubtedly correct in law but the reasoning by which it was arrived at is questionable. It upholds the security of registered transactions, which serves the public interest, but Mrs Scott lost her home and was left without a remedy.

Sale and rent back transactions are now a regulated activity under s 19 of the Financial Services and Markets Act 2009 as a result of which the market appears to have closed down. But it does not follow that isolated cases will not occur. In the Court of Appeal it was emphasised that the problem would not have arisen if the contract had set out the terms relating to the future occupation of the property. Quite so: but it does seem that the vendor was tricked.

It is suggested that in any sale and rent back transaction the vendor's solicitor should be especially diligent to ascertain his client's intention as to occupation of the property after completion and ensure that the contract reflects that intention; and for "belt and braces" he should also obtain confirmation either that the purchaser does not intend to raise a mortgage loan or that the lender agrees to his client's interest having priority. **NLJ**

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