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A work in progress

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The *Pallant v Morgan* equity is a generator of uncertainty, says Jonathan Fowles

- **The *Pallant v Morgan* equity in its current form is arguably an unwelcome intrusion by equity into commercial affairs.**
- **The High Court has recently confirmed that parties cannot exclude it simply by the use of the phrase "subject to contract".**

The precise scope and nature of the so-called *Pallant v Morgan* equity is still being worked out by the courts. A recent High Court decision (*Generator Developments LLP v Lidl* [2016] EWHC 814 (Ch), [2016] All ER (D) 164 (Apr)) illustrates the uncertainty which the background threat of such an equity may cause in commercial transactions, and underscores the difficulty of setting its boundaries, even aside from debate as to its juridical justification.

Pre-requisites of the equity

The equity distinctively arises out of joint venture relationships in relation to the acquisition of real property. It depends on a pre-acquisition arrangement between the parties to the joint venture "which colours the subsequent acquisition by the defendant and leads to his being treated as a trustee if he seeks to act inconsistently with it" (*Banner Homes Plc v Luff Developments Ltd* [2000] Ch 372, [2000] 2 All ER 117). But the reason it tends to be invoked is precisely because at some stage negotiations have failed and there is no

legally enforceable agreement. The further pre-requisites of the equity are that:

1. The pre-acquisition arrangement should contemplate: (i) one party taking steps to acquire the property; and (ii) the other party obtaining some interest in the property if it succeeds in doing so.
2. The acquiring party should not have informed the non-acquiring party that it no longer intends to honour the arrangement before it is too late for the parties to be restored to a position of no advantage/no detriment.
3. In reliance on the arrangement, the non-acquiring party should do (or omit to do) something which confers an advantage on the acquiring party in relation to the acquisition; or is detrimental to the ability of the non-acquiring party to acquire the property on equal terms.

Generator Developments was principally concerned with the question whether there was a sufficient pre-acquisition arrangement, and in particular an arrangement or understanding that the non-acquiring party would obtain some interest in the acquired property (see (a)ii above). The court also addressed the prior but related question of whether it was simply fatal to the non-acquiring party's claim that the relevant negotiations were conducted on an expressly "subject to contract" basis. The case will be explored in more detail below, but at this stage it is helpful to note the way in which the judge (Nicholas Lavender QC, sitting as a Deputy High Court Judge) directed himself on the principal question: "Since the alleged arrangement or understanding was not a contract, it is not a question of looking for the acceptance of an offer, but rather of assessing all the relevant evidence as to what the parties said and did."

On current binding authority at Court of Appeal level, this is obviously correct. However, it points to the way in which the *Pallant v Morgan* equity, as presently characterised in authority, may be viewed as an unwelcome intrusion by equity in the commercial world, and may have been viewed by the defendant, and even with hindsight by the claimant who relied on it, as a source of uncertainty and litigation.

Crossco

The judge's self-direction in *Generator* reflects the most recent discussion of the equity in the Court of Appeal, where there may have been an opportunity to limit the equity's scope for harm. In *Crossco No. 4 Unlimited v Jolan Ltd* [2011] EWCA Civ 1619, [2012] 2 All ER 754, the majority of the Court of Appeal (Arden and McFarlane LJJ) held that *Banner* remained binding authority for the proposition that the equity is a species of common intention constructive trust, ie the trust explained in a cohabitation context by cases such as *Gissing v Gissing* [1971] AC 886, [1970] 2 All ER 780 and *Jones v Kernott* [2011] UKSC 53, [2012] 1 AC 776. The proportions in which the beneficial interest is divided under such a trust may be ascertained by the court's consideration of the whole of the parties' course of conduct. This exercise may extend to the

imputation to the parties of intentions which they never actually had; imputation of this sort does not enter into any assessment of whether a trust arose in the first place, ie whether there was a common intention for shared ownership at all: see *Jones v Kernott* at 788-89 per Lord Walker and Baroness Hale JJSC.

In *Crossco* Etherton LJ disagreed with the majority, arguing that the true basis for the equity was breach of fiduciary duty on the ground, among others, that this would better serve the needs of certainty in commercial negotiations. As his Lordship said forcefully: "In a commercial context, it is to be expected that the parties will normally take legal advice about their respective rights and interests and will normally reduce their agreements to writing and will not expect to be bound until a contract has been made...They do not expect their rights to be determined in an 'ambulatory' manner by retrospective examination of their conduct and words over the entire period of their relationship. They do not expect the court to determine their respective property rights and interests by the imputation of intentions which they did not have but which the court considers they would have if they had acted justly and reasonably and thought about the point."

The Court of Appeal agreed in their decision in *Crossco* , dismissing the claim to an equity regardless of its juridical basis. Further, the majority sympathised with Etherton LJ's arguments, even if they could not agree on the jurisprudential effect of *Banner Homes* .

The choice for the court

So it was that, as a result, in *Generator* the judge was compelled to sift through the parties' course of conduct in a way that, absent authority, the Court of Appeal in *Crossco* might have preferred he did not have to. In this context, and in the context of the jurisprudential debate about the nature of the *Pallant v Morgan* equity, the question in *Generator* of the use of the words "subject to contract" was particularly tricky. Viewed independently of the authorities, the choice for the court in *Generator* was either:

1. to attempt to limit the scope of the equity by allowing commercial parties to shut out the equity by including the words "subject to contract" in their draft "Heads of Terms" but in doing so draw an artificial distinction between the express and implied adoption of the words; or
2. to leave open the possibility that the use by the parties of the words "subject to contract" would not, contrary perhaps to normal expectation, exclude one joint venturer's right legitimately to complain of unconscionable conduct where the other invoked those words to withdraw from the venture.

Generator Developments

In *Generator Developments LLP v Lidl* a property development LLP sought to

assert a *Pallant v Morgan* equity over an industrial estate purchased by Lidl UK, the supermarket chain, following an exchange of contracts between Lidl and the vendor in February 2014.

Residential use for the site had been mooted by the borough council in the summer of 2013. In autumn 2013 the parties were rivals for the potential purchase of the site, but at the suggestion of the vendor's agent, they began communications as to their respective interests. Thereafter, Generator made a number of offers to buy the property the terms of which were agreed with Lidl. Finally, towards the end of November 2013 the vendor accepted an offer from Generator of £6,510,000 plus one of the flats to be built at the site. However, the heads of terms agreed by Generator and Lidl and sent to the vendor named Lidl as the purchaser and Generator as the "delivery partner"; likewise in a lockout agreement between the parties and the vendor.

Subsequently, Lidl and Generator worked on a number of drafts of heads of terms for a joint venture for the development of a retail store and residential flats and the sale-and-leaseback of a retail store on the site. The proposed transaction was conditional on the grant of planning permission but, if Generator succeeded in obtaining planning permission, Lidl would sell the freehold of the property to Generator, Generator would build the store and the flats, and Generator would then grant a 999-year lease of the store to Lidl. Each draft of the joint venture heads of terms contained the words "subject to contract" and made clear that the proposed transaction was subject to approval by the respective boards of each company.

The heads of terms went through several drafts but no joint venture agreement had been concluded by the time that Lidl as sole purchaser exchanged contracts for the purchase of the property with Generator's blessing on Valentine's Day 2014. As the deputy judge noted, that would have to have been the point at which any *Pallant v Morgan* equity arose, so that events after this time were of less significance in determining whether an equity had arisen.

Joint venture negotiations continued after the exchange of contracts. However, Lidl did start to approach other house-builders to explore whether equity had arisen.

Joint venture negotiations continued after the exchange of contracts. However, Lidl did start to approach other house-builders to explore whether a better price might be obtained for the site. Eventually, following a total of seven drafts of the heads of terms, none of which had been agreed, Lidl pulled out of negotiations on 28 April 2014.

Generator therefore started proceedings claiming a *Pallant v Morgan* equity over the property. The question of what relief such an equity would entail was not a question before the deputy judge.

The deputy judge held that no such equity had arisen because there had been no sufficient pre-acquisition arrangement between the parties. The judge gave a number of reasons for this finding, including that no assurances were

given by Lidl to Generator to the effect that Generator would definitely acquire an interest in the property if Lidl purchased it. In various respects, Generator could be taken to have been aware of the risk that Lidl would not commit itself to the joint venture.

As a preliminary point of discussion, the deputy judge had held that in and of itself the use of the phrase "subject to contract" was not fatal to the claim. Given his eventual decision, this aspect of the decision is probably obiter; he did not need to decide the question in order to decide the case. The deputy judge's conclusion in this respect is surely right.

At the heart of Generator's argument in this respect was the proposition that in *London & Regional Investments Limited v TBI Plc* [2002] EWCA Civ 355, [2002] All ER (D) 360 (Mar) the Court of Appeal had held that the express use of the words "subject to contract" rules out a *Pallant v Morgan* equity. This was supposed to be contrasted with the position in *Banner Homes* , where the Court of Appeal had held that it made no difference that the parties had not intended to enter into a binding agreement except by way of and until a shareholders' agreement, and that to that extent their arrangement was impliedly subject to contract.

But, as Lord Scott had explained in *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55, [2008] 4 All ER 713, the *London & Regional* case was outside the scope of the *Pallant v Morgan* principle since it related not to a pre-acquisition arrangement but negotiations for lands already owned by one of the parties: 1771. In that context, the express use of the words "subject to contract" simply spelt out the need for concluded agreement for the disposal of the joint venture land in the context of a written agreement for the sale of other land which did comply with s 2 of the Law of Property (Miscellaneous Provisions) Act 1989 (LP(MP)A 1989). The importance of the words had therefore to do with excluding contractual obligations, and nothing less than a binding contract would assist the claimant in such a case.

Further, if the mere use of the words "subject to contract" was sufficient to rule out a *Pallant v Morgan* equity, it would need to be explained why their use would have a stronger effect where a constructive trust was alleged than in respect of allegations of proprietary estoppel. In the latter cases, it is settled that such words are not an absolute bar to an estoppel arising, even if they may ordinarily be fatal to it: *Cobbe* at 1767 per Lord Scott, quoting *Attorney General of Hong Kong v Humphreys Estate* [1987] AC 114, [1987] 2 All ER 387. It is true that, whereas there is an exception to the need for written agreement for resulting, implied, and constructive trusts in s 2(5) of LP(MP)A 1989, there is no such exception for proprietary estoppel. But this is not a point of distinction in respect of the use of the phrase "subject to contract" since it is only usually required where there is otherwise a risk that an agreement is in writing sufficient to comply with s 2 of LP(MP)A 1989: see *Cobbe* at 1784 per Lord Walker.

Down but not out

It is striking that the deputy judge's decision on the facts in *Generator* was supported by his finding that the parties well understood the meaning and effect of the words "subject to contract". It is easy to see that, even if the words "subject to contract" are not a complete bar to a claim to a *Pallant v Morgan* equity, they make it far less likely that the court will find a sufficient pre-acquisition arrangement or, I would suggest, less likely that the court will find true reliance on such an arrangement. This is perhaps the best explanation of the judicial dicta deployed by *Generator* in support of its argument: see eg *Kilcarne Holdings Ltd v Targetfollow* [2004] EWHC 2547 (Ch), [2005] 2 P&CR 8 at [229].

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