Shortfalls on Sale

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1. In this paper I wish to discuss some issues and considerations which arise when it is expected that there will be a shortfall upon a sale of the mortgaged property following a default.

2. Where the mortgagee proceeds immediately to sale, and the mortgagor (and his sureties) either pay up or go bankrupt there is little left to do. However, often mortgagees choose to hold off enforcement of the security, or choose not to bankrupt the mortgagor. In these circumstances, to ensure that necessary steps are taken to preserve or enforce the security, it is necessary to have a proper understanding of the limitation provisions that apply.

Limitation

3. Separate Limitation issues arise in relation to:

   (a) Enforcement of the covenant to repay;

   (b) Enforcement of the covenant to pay interest;

   (c) Enforcement of the security

Claims upon the obligation to repay the principal

4. The limitation position in relation to the covenant to repay is now relatively clear. S. 20 of the Limitation Act provides:

> ***Time limit for actions to recover money secured by a mortgage or charge or to recover proceeds of the sale of land.***
>
> *20 (1) No action shall be brought to recover—*
> *(a) any principal sum of money secured by a mortgage or other charge on property (whether real or personal); or*
> *(b) proceeds of the sale of land;*

> *after the expiration of twelve years from the date on which the right to receive the money accrued*

5. In previous cases (largely unsuccessful) attempts had been made to subvert the effect of this provision, both for and against the banks. For example, an attempt to assert that, once the security was realised upon a sale, the covenant to pay within the mortgage deed was discharged and replaced by an implied obligation to pay the shortfall – to which a 6 year limitation period would apply[1] – had already failed in the Court of Appeal in *Bristol & West plc v. Bartlett [2003] 1 WLR 284.*

6. In *West Bromwich BS v. Wilkinson [2005] 1 WLR 2303* the House of Lords confirmed that s. 20 applies to claims brought after the property has been sold, and that time runs from the (on the construction of the mortgage) the debt was repayable when the power of sale became exercisable. The fact of the sale and removal of security did not mean that the shortfall was no longer "secured by a mortgage", such that s. 8 of the Limitation Act (actions upon a specialty) applied instead[2] and such that time began to run again.

Mortgage Interest

7. Although the period for recovery of the principal sum is therefore 12 years from default, s. 20(5) applies a different period to claims for interest:

> *... no action to recover arrears of interest payable in respect of any sum of money secured by a mortgage or other charge or payable in respect of proceeds of the sale of land, or to recover damages in respect of such arrears shall be brought after the expiration of 6 years from the date on which interest became due.*

8. However, once the principal sum is barred, all interest is barred, not just interest which accrued more than 6 years previously[3].

Claims for recovery of possession

9. S. 15(1) of the Limitation Act 1980 provides:

[1] By virtue of s. 5 Limitation Act 1980
[2] By virtue of s. 12 Limitation Act 1980
[3] Elder v. Northcot [1930] 2 Ch 422

> *No action shall be brought by any person to recover any land after the expiration of twelve years from the date on which the right of action accrued to him or, if it first accrued to some person through whom he claims, to that person.*

10. The relevant part of s. 17 provides:

> *... at the expiration of the period prescribed by this Act for any person to bring an action to recover land (including a redemption action) the title of that person to the land shall be extinguished.*

11. By virtue of s. 38(7):

> *References in this Act to a right of action to recover land shall include references to a right to enter into possession of the land ... and references to the bringing of such an action shall include references to the making of such an entry...*

12. Although a mortgagee under a legal mortgage[4] has a right of entry upon execution of the mortgage, the qualification of the right of possession by the need for default means that the right of possession, and therefore the running of time, does not generally arise until default.

13. The application of ss. 15 and 17 to mortgagors remaining in possession after a default was definitively considered by the Court of Appeal in *Ashe v. NatWest Bank plc [2008] 1 WLR 710*: In September 2006 Mr Ashe, the trustee in bankruptcy of the mortgagor, brought proceedings seeking a declaration that NatWest's interest under their mortgage had been extinguished. The mortgagor's last payment was made in March 1993, therefore more than 12 years before the issue of the claim.

14. NatWest relied upon paragraph 8 of Schedule 1 of the 1980 Act, which provides:

> *No right of action to recover land shall be treated as accruing unless the land is in the possession of some person in whose favour the period of limitation can run (referred to below in this paragraph as "adverse possession"...*

[4] An equitable mortgagee has no automatic right of possession prior to an order of the court unless the mortgage expressly provides one.

15. The bank argued that the possession of the property since the grant of the charge[5], and since the date of the last payment, was with the express or implied permission of the bank, and was therefore not 'adverse possession'. Since the mortgagor was not in 'adverse possession' no right of action had accrued and time, which by virtue of s. 15 ran from the accrual of the right of action, had not begun to run.

16. At first instance[6] the judge held that paragraph 8(1) did not apply to claims by a mortgagee against a mortgagor, and that the mortgagor was, in any event, in adverse possession from the point at which they had ceased paying.

17. The Court of Appeal[7] held that the first instance judge was wrong on the first point[8] but right on the second. The Court rejected NatWest's contention that the possession of a defaulting mortgagor was not 'adverse': 'adverse possession' refers to the capacity of the person in possession, rather than the nature of that possession. All that this term connoted was the requirement of "ordinary possession" of the property, which is exclusive possession, by a person in whose favour time could run.

18. The Court explained that the effect of the grant of permission is that, during the continuance of the permission, a person otherwise entitled to possession has no right of action to recover possession against the recipient of the permission. However, the Court rejected the suggestion that the mortgagor was in possession with the permission of the Bank. Since the last default the bank had merely tolerated the original mortgagor's continuing possession. It was not necessary to infer from this possession that the bank had granted permission. The continued presence of the mortgagor could be adequately explained as being referable to his interest in the property (he remained the registered legal owner of it).

[5] The bank, upon the true construction of the charge, having an immediate right to possession under the charge from the point of its execution.
[6] Decision of Richard Arnold QC sitting as a deputy judge of the Ch.D [2007] 2 P&CR 525
[7] Mummer LJ, with whom Hughes LJ and David Richards J agreed.
[8] Which was in fact conceded by NatWest upon the appeal.

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19. Since the mortgagor was in possession, and since bank had not displaced its right of action by granting any relevant permission, the bank's right of action remained live, and therefore time ran[9].

Acknowledgements & Part-Payment

20. In *Ashe* the Court of Appeal brushed aside the usual warnings by the lender that a decision against them would force the hands of banks to evict people faster than would otherwise be the case. Although the Court recognised that *"it may come as an unpleasant surprise to the bank and other mortgagees that their mortgagors are in adverse possession of the mortgaged property"*[10], the court held that lenders could easily take steps to stop time running, short of obtaining possession – a reference to acknowledgement and part payment.

21. The combined effects of s. 29 and 30 are that acknowledgements of the mortgagees' claims or payments towards the debt, have the effect that the causes of action are treated as having accrued afresh[11]. The issue of who may acknowledge or make part-payment to extend time is intricate:

    (1) For an acknowledgement to refresh the mortgagee's cause of action to recover land it must be made by the person in possession of the land[12] or his agent[13].

    (2) For a part-payment to refresh the cause of action to recover land it may be made *either* by the person in possession of land *or* by the person liable or accountable for the claim or (in either case) his agent[14].

    (3) For an acknowledgement or part-payment to refresh the claim upon the covenant, it must be made by the person liable or accountable for the claim or his agent[15]. This includes the surety of the mortgagor or anyone who (as between mortgagor and that person) is bound to pay. However, the payment must be *"in respect of"* the debt, so a payment of rent by the tenant of the mortgagor to the mortgagee will not suffice, but a payment over to the mortgagee of rent paid to a receiver by the tenant will.

[10] Mummery LJ, para 88
[11] This has no effect upon a claim which has already become statute-barred: s. 29(7).
[12] S. 29(2) and s. 29(3)
[13] S. 30(2)
[14] S. 29(3)
[15] S. 29(5)

22. Acknowledgements must be made by signed writing[16], but no particular form is required. It is ultimately a matter of construction whether or not an acknowledgement is sufficiently clear. There is no need for any express or implied promise to pay. There is also now no doubt that an acknowledgement need only sufficiently identify the debt, and not quantify it[17].

23. It should be noted that by virtue of the statutory wording, part-payments of interest have the odd effect of renewing the cause of action on the principal, but not upon the interest itself[18].

24. A written acknowledgement or part-payment of the mortgagee's right to possession by anyone in possession binds everyone in possession. A part-payment by joint debtors binds all debtors[19]. But a written acknowledgement of the mortgage debt binds only the maker of it and his assigns.

'without prejudice' acknowledgements

25. The application of the 'without prejudice' privilege to acknowledgements was definitively settled in *Bradford & Bingley plc v. Rashid [2006] 1 WLR 2066.* Mr Rashid made his last mortgage payment in January 1991 after which an order for possession was obtained and the property sold, leaving a shortfall of about £15,500. In June 2003 the bank brought proceedings to recover the shortfall. The bank relied upon two letters from Mr Rashid's solicitors in September/October 2001[20], both making offers of sorts, as acknowledgments of the debt. In the first Mr Rashid sought a period of grace, after which Mr Rashid would start to repay; n the second, he offered a sum "as a final settlement".

[16] S. 30(1)
[17] Bradford & Bingley plc v. Rashid [2006] 1 WLR 2066
[18] S. 29(6).
[19] *Allison v. Frisby (1889) 43 Ch D 106*
[20] Therefore less than 12 years after the most recent-payment and less than 12 years before the start of proceedings.

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26. Mr Rashid argued that the letters were subject to the *"without prejudice"* privilege and the Court of Appeal agreed[21]. The House of Lords did not. All their lordships found that the documents were admissible into evidence, and effective acknowledgements; the majority did so upon the basis that the privilege did not apply to apparently open communications designed only to discuss the repayment of an admitted liability, rather than to negotiate and compromise a disputed liability[22].

Two notes about judgments

A note on[23] interest

27. It is worth remembering, when considering the enforcement of judgments, that at common law the effect of a judgment is to merge and extinguish the original contractual debt in the judgment. If interest is due under the contract it is considered ancillary to the covenant to pay the principal, so that the obligation to pay the interest also merges in the judgment and is extinguished.

28. This common law principle gives way to express wording of the instrument, either to the effect that interest will continue to run on the debt, or where the covenant is worded to require payment of interest on any sum due on the security, whether it is owing on the covenant or by virtue of judgment[24]. Such provisions are common (but strangely not universal) and have been held not to be unfair terms within the bounds of the Unfair Terms in Consumer Contracts Regulations 1999[25]

29. If the mortgage instrument is not satisfactorily worded, so that the contractual/covenanted obligation to pay interest does not survive, the effect of obtaining a money judgment may be to vary the rate of interest payable on the amount outstanding to the judgment rate. This is not all bad, since the judgement rate is

[21] [2005] EWCA Civ 1080.
[22] Lord Hoffmann held that as a matter of public policy the privilege should not apply to an acknowledgment; Lord Hope held that it did not apply to clear admissions of fact not forming part of an offer of compromise or in the context of a dispute.
[23] *but not necessarily "of interest"*
[24] Economic Life Assurance Society v. Usborn [1902] AC 147,
[25] Director General of Fair Trading v. First National Bank plc [2002] 1 AC 481

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currently 8%[26], but interest is not payable on all judgments[27]. Although the court has power to adjust the period of the interest (CPR 40.8), it does not appear to have any power to adjust the rate.

Enforcement of old judgments

30. Not infrequently a mortgagee is in the position of having obtained an historic money judgment which, at the time, was 'not worth the powder and shot' of enforcing. Where the mortgagor has not become bankrupt in the interim, the issue of enforcement of the old judgment may arise.

31. S. 24 of the 1980 Act makes actions upon a judgment subject to a 6 year limitation period. However, actions upon a judgment are an historical anachronism and are no longer of any real relevance.

32. The enforcement of an existing judgment by any of the usual methods is not an action on a judgment[28] but merely a procedural step within an existing action. The time for commencement of the process of enforcement is therefore not regulated by the Limitation Act 1980 at all. However, the rules[29] nevertheless do restrict the ability to enforce stale judgments by imposing a requirement that, once a judgment is 6 years old, a judgment creditor must seek leave to commence the enforcement process[30].

33. In *Patel v. Singh [2002] EWCA Civ 1938* Peter Gibson LJ held that ordinarily permission will not be given after 6 years unless the circumstances of the case take it out of the ordinary[31]. The example he gave was the judgment debtor winning the lottery.

[26] In the High Court by virtue of s. 17 of the Judgments Act 1838 as varied; In the County Court by s. 74 of the County Courts Act 1984 and subordinate legislation.
[27] for example in the County Court interest is not applied to orders where a mortgagee is granted a suspended possession order (see County Courts (Interest on Judgment Debts) Order 1991 (SI 1991/1184) Art 2(3).
[28] *Lowsley v. Forbes [1999] AC 329*
[29] RSC Ord. 46; CCR Ord 26
[30] In the High Court there is an express requirement under Ord 46 r 4 that in his evidence upon the application the judgment creditor must explain his delay.
[31] Peter Gibson LJ referred, with apparent approval, to the statement of Evans-Lombe J in *Duer v. Frazer [2001] 1 WLR 919* to the effect that the court would only extend time when the judgment creditor had established that it was "demonstrably just to do so."

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34. As a side note, and to bring the matter full circle, in *Yorkshire Bank Finance Ltd v. Mulhall [2008] EWCA 1156* the Court of Appeal confirmed that:

(1) s. 20 does not apply to charging orders, since s. 20 applies to 'actions to recover' the principal or interest. Neither the enforcement of a charging order, nor the redemption of it, amounted to such an action;

(2) ss. 15 and 17 would not apply either, since a charging order was enforceable in the same manner as an equitable charge created under hand. Since an equitable charge holder had no right of possession, so time could never start to run.

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