**Chapter 8**

**Question 1: Why is the legal charge by way of mortgage described as a hybrid security?**

We explore the nature of the legal charge by way of mortgage further in Paragraphs 8.13-8.14 and the inherent nature of a mortgage and a charge in Paragraphs 8.10 and 8.11 respectively. A legal charge by way of mortgage of land is described as a hybrid security because, although in legal form it is created by way of charge, section 87(1) of the Law of Property Act 1925 provides that a legal chargee is to enjoy the same protections, powers and remedies as if a legal mortgage had been created by vesting a lease for 3,000 years in the lender. Thus, unfortunately the rather bizarre fiction in the traditional form of mortgage by sub-demise continues - namely that the lender is treated as a tenant entitled to immediate exclusive possession.

**Question 2:** **What advantages would there be if the Law Commission’s recommendation to reform the forms of security of land was enacted?**

The Law Commission’s Report No 204, which was published as long ago as 1991, is considered in Paragraph 8.28.

The Law Commission’s Report criticised the confusion that exists between the forms of mortgage and charge in the legal charge by way of mortgage and recommend its replacement by a statutory form of security which would clearly define the relationship between the borrower and lender. By so doing, the confusion resulting from the distinction between the mortgage and charge and inappropriateness of the hybrid legal charge by way of mortgage, perpetrating as it does the fiction that lies at the heart of the mortgage form, would be removed.

In relation to equitable security interests in land, the Law Commission noted the unnecessary complexity of the three forms of equitable security and advocated the rationalisation of these forms by recognising that the new statutory form of mortgage may be created either formally or informally. These forms of equitable security are described in paragraphs 8.15-8.22.

Students are referred to the Law Commission Report No 204 for more detail of the Law Commission’s proposals.

**Question 3:** **What do we mean by an equity of redemption?**

The concept of the borrower’s equity of redemption is examined in Paragraphs 8.29-8.30. Under the traditional mortgage by way of conveyance or sub-demise the borrower’s equity of redemption was of fundamental importance. Indeed, its development was a key achievement of the chancery courts.

However, all mortgages of land must now be created by way of legal charge – see section 23 of the Land Registration Act 2002. Both Nield and Watt argue that the concept of the borrower’s equity of redemption under a legal charge by way of mortgage is unnecessary and should be abandoned as perpetrating the fiction of the legal mortgage by conveyance which sees the lender as the owner of the land and the borrower as the holder of a mere equity of redemption. The courts are even sometimes beguiled by this fiction; see for example *Abbey National Building Society v Cann*, considered in Sawyer in *A World Safe for Mortgagees – Registering a Scintilla of Doubt in Cooke* (edn. Modern Studies in Property Law Vol 1) Hart 2001, 201, *Horsham Properties Group Ltd v Clarke, Scott v South Pacific Mortgages Ltd.*

It remains important nevertheless to continue to recognise the borrower’s equitable right to redeem, entitling them to repay and discharge the lender’s security even though the contractual date for repayment agreed by the parties may have passed.

**Question 4:** **Is it now true to say that a lender enjoys an immediate right to possession?**

The lender’s right to possession and qualifications to that right are considered in Paragraphs 8.40-8.54.

These qualifications relate almost exclusively to domestic premises and do effectively curtail the lender’s immediate right to take possession of occupied domestic premises other than by court order which then in turn engages the protection afforded by the pre-action protocol upon possession actions for mortgage arrears and section 36 of the Administration of Justice Act 1970 (as amended). These qualifications reflect the view promoted by MCOB 13 that possession should be considered a right of last resort which should not be exercised until all attempts to help the borrower clear the arrears have been considered.

The gap in borrower protection arises where the lender does not seek any order for possession either because the premises are not presently occupied by the borrower or the borrower voluntarily gives up possession to the lender. The latter situation is not uncommon and may reflect a borrower’s feeling of hopelessness in the face of their financial troubles. Examples of the former situation are *Ropaigealach v Barclays Bank plc*, where the borrowers were temporarily absent from the property which was undergoing renovation, and *Horsham Properties Group Ltd v Clark*, where the property was let out by the borrower. The worrying aspect of these two cases is that the lender was able to sell the properties concerned without the borrower being informed or aware of the sale and thus had no opportunity to question the lender’s right or try and repay the arrears. It sparked such concern that The Ministry of Justice consulted on the issue however no legislative change has been forthcoming perhaps because the Council of Mortgage Lenders have issued guidance to their members that possession should be obtained by court order.

**Question 5: To what extent does the court’s discretion under section 36 of the AJA 1970 dovetail (if at all) with the standards of forbearance required by MCOB 13?**

The court’s discretion under section 36 applies near the end of the possession process when the mortgagee seeks a possession order. Under section 36, the courts may adjourn the possession proceedings or delay the execution of the possession order they are bound to make – remember that the mortgagee has *a right* to possession. By contrast, the rules of business conduct found in MCOB 13 look to the start of the enforcement process by requiring the mortgagee to explore forbearance even before any court process is initiated. The Pre-action Protocol is intended to ensure that the mortgagee has done so by requiring such evidence before possession proceedings can be issued. Accordingly, anecdotal evidence suggests that the use of section 36 has declined.

The purpose of the court’s discretion under section 36 and the standards of conduct expected by MCOB are similar. They are intent on giving the borrower time to pay. Inevitably, the provisions are framed differently given that section 36 is statutory and adjudicated by the courts and the MCOB 13 is a regulatory code overseen by the FCA, as regulator, and often adjudicated by the Financial Ombudsman Service.

You are referred to Paragraphs 8.36-8.39, 8.43-8.54 and 8.73-8.85 for further information on the significance and operation of both section 36 and market regulation, particularly MCOB 13.

**Question 6:** **A lender can sell the mortgaged property without the consent of the court but what controls are there over how they do so?**

A power for a lender to sell the mortgaged property may be expressly conferred by the mortgage itself or is implied by section 101 of the LPA 1925 where the mortgage is created by deed. Most mortgages will be created by deed and thus enjoy this implied power.

A lender owes twin duties to act in good faith and to take reasonable care to obtain a proper price for the property should he or she exercise this power of sale. These duties arises in equity and are based upon the lender:borrower relationship which confers upon the lender a power to sell the mortgaged property in the event of default. The breach of this duty will render the lender liable to account not just for what he or she receives but for what they ought to have received if they had acted in accordance with the duty placed upon them.

The lender’s duty to obtain a proper market price does not mean that the lender has to obtain a price which reflects a hypothetical valuation of what the property would sell for on the open market. Rather, the duty focuses upon what steps the lender has taken to market the property to try and ensure that the property has been properly exposed to the market and thus a proper market value achieved. In particular, the court is concerned to see that the lender has taken the advice of experts to ensure that the property is properly marketed. Proper advertisement and mode of sale are particularly important. The lender however may choose the time of sale and is not obliged to take steps to enhance the value of the property.

The source of the lender’s power of sale and their duties are considered in Paragraphs 8.55-8.63.

**Question 7: Contrast the duties in the enforcement of the mortgage security owed by a lender and a receiver.**

Loi in his article referred to in the Further Reading points out that a lender, in protecting their own interests in exercise of their power of sale, is not liable to the borrower on the basis of nonfeasance but only for misfeasance if they choose to exercise their power. Thus, a lender is free to choose the time of sale but when they make that decision to sell they must demonstrate good faith and the required standards of care. A receiver by contrast is managing the mortgaged property and as such is required to act. The difference is illustrated by the case of *Medforth v Blake*. Receivers owe a duty to their principal, the borrower, but an overriding duty to the lender to exercise their powers to recover the mortgage debt and pursuant to whose interests they are appointed. This overriding duty impacts upon the nature of their duties to the borrower and thus for instance provides some latitude in when they can decide to act.

Further details on receivers and their duties are found in Paragraphs 8.64-8.67.

**Question 8:** **How does the FSMA 2000 ‘protect’ borrowers?**

Market regulation operating through the FSMA 2000 is considered in Paragraphs 8.73-8.84.

This regulation of the domestic mortgage market covers both first and second mortgages over the home as well as other forms of credit facility – such as equity release schemes and Islamic finance. It is based upon the principles of decentered market regulation where the object of regulation is to create an open and competitive market in which borrowers can make informed choices best suited to their needs through the provision of standardized comparative information for instance regarding interest rates, repayment instalments and penalty charges. Within this market borrowers are thus expected to be equipped to borrow responsibly and lenders to lend responsibly. However, the credit crunch exposed the weakness of de-centered market regulation, particularly lenders’ failure to lend responsibly which triggered a wave of activity amongst regulators, both at national and European level, to ensure that lenders take greater care when deciding to lend. In the UK, the Mortgage Market Review triggered changes requiring lenders to take greater responsibility for their lending decisions for instance by undertaking affordability checks and providing advice to borrowers on the suitability of their mortgage. The Mortgage Credit Directive has reinforced this shift of responsibility and introduced other technical changes to the way in which lenders are required to behave to provide greater borrower protection.

The main mechanisms by which regulation operates is through the licensing of lenders, compliance with conduct of business principles, rules and guidance and finally enforcement primarily through the Financial Conduct Authority’s (FCA) monitoring and enforcement powers. Thus, lenders wishing to enter this market must be licensed and may be subject to disciplinary proceedings by the FCA for a failure to license or to observe the conduct of business standards. These standard adopt what has been called a ‘cradle to grave’ approach by setting out in detail the steps and information that must be provided to the borrower throughout the course of the transaction from the lender’s marketing of the loan and the borrower’s first approach to the lender through to the mortgage offer and completion of the transactions. There are also requirements governing information that must be provided to the borrower during the course of the mortgage and provisions regulating the lender’s actions should the borrower default.

**Question 9:** **What impact does the FOS have upon the resolution of mortgage disputes?**

Details of the FOS role and powers are found in Paragraph 8.85.

The FOS provides an accessible, cheap and efficient means by which a borrower can resolve disputes with their lender on the basis of what is fair and reasonable rather than by looking solely to the strict legal effect of the parties’ relationship. The FOS has provided a route through which recent miss-selling scandals have been addressed for instance the miss-selling of endowment mortgages and payment protection insurance.

Whether their undoubted good work is sufficient and effective is limited by the financial cap on the monetary awards the FOS can make and the FOS’ reluctance and limited ability to affect the proprietary relationship created by the mortgage.

**Question 10:** **In commenting upon undue influence and misrepresentation in the context of surety mortgages over the home, why were the House of Lords keen to ensure that ‘a law designed to protect the vulnerable does not render the matrimonial home unacceptable security to financial institutions’?**

The House of Lords were clearly concerned to try and strike a balance between the sanctity of the family home and the commercial support for small and medium size businesses. The latter are often unable to obtain adequate financial support from banks and other lenders unless they can offer security and the only feasible security is usually the business proprietor’s family home.

The decision in *Barclays Bank v O’Brien* heralded a significant and innovative development in the application of the concept of notice that was utilized by many wives to try and save the family home in the event of the family business’ insolvency. However, lenders became worried as they struggled to address the risk that a husband may have misrepresented the financial situation to his wife or might have unduly influenced her. In light of concern from lenders that the balance had swung too far in favour of the wife, the House of Lords in *Royal Bank of Scotland v Etridge* recast the balance outlined a practical and cost efficient process that could be implemented by lenders whilst providing a measure of protection to the wife. They clarified the evidential hurdle to proof undue influence which is the necessary first step that a wife must establish. They then set out a simple evidential test for second step - namely that the bank should have notice of the risk of undue influence or misrepresentation in all non-commercial surety transactions. Lastly, the House of Lords set out the steps that a lender should take in these circumstances.

Those steps centre upon on the provision of independent advice to the wife to try and ensure that she enters into the mortgage aware of the risks. A wife who has received inadequate or negligent advice would have a personal cause of action against her adviser, usually a solicitor, rather than a proprietary protection of her interest in the family home.

Nevertheless, concerns still remain over the independence of advisers where that adviser is a solicitor who also represents the husband as well as the competence of solicitors to give adequate advice of the commercial, as opposed to the legal, risks of this type of mortgage. Feminist legal scholars have also highlighted the dangers of what has been called ‘sexually transmitted debt’ when wives face the dilemma of making the often very difficult and emotionally challenging choice between the risks to family home and the business aspirations of their husband. This difficult choice is one that is not confined to wives but to others in an emotionally dependent relationship for instance cohabiting hetero or same sex partners and parents and their children.

Details of the House of Lords’ guidance can be found in Paragraphs 8.91-8.104.

**Question 11:** **Explain the distinction between the tests of ‘oppression and unconscionability’ and ‘unfairness’ in the control of mortgage terms.**

The court’s ability to control mortgage terms is considered in Paragraphs 8.105-8.120.

The test of ‘oppression and unconscionability’ has been developed by equity to indicate when it is prepared to step in to strike down a mortgage term. It is a high test to pass which goes beyond the mere unreasonableness of a particular term. The test tends to looks at whether the substance of the term would ‘shock the conscience of the court’ and also just how freely the borrower consented to the term. For instance, were they financially experienced or have the benefit of professional advice? The test is still applicable to commercial mortgages but the terms governing borrowing by consumer, including domestic borrowers, is more tightly controlled by a statutory test of unfairness now found in the Consumer Rights Act 2010.

An unfair term is not binding upon the borrower and the FCA and Consumer Markets Authority (CMA) may exercise its powers to try and ensure that unfair terms are not employed. However, it is only the standard terms of the mortgage, which are not individually negotiated, that must satisfy the need for fairness. Also the core consideration terms of the mortgage eg the interest rate charged is not subject to the test of ‘unfairness’. The definition of when a term is unfair is found in section 62 of the CRA 2015 which provides that a term is ‘unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer’. This test of unfairness encompasses both a lack of good faith and a significant imbalance in the rights and liabilities of the parties which operates to the detriment of the borrower – see *Director General of Fair Trading v First National Bank Plc*. It is supplemented by a non-exhaustive ‘grey list’ of terms which potentially may be regarded as unfair– see section 63. In addition, the FCA and CMA have issued guidance on their view of the test.