§ Law in Context

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# Property Law

## Commentary and Materials

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# 14

# Enforceability and priority of interests

## 14.1. Rationale of enforceability and priority rules

Any legal system that allows multiple property interests to subsist in the same thing at the same time must have rules governing their enforceability and priority. Enforceability questions arise when O, the holder of a property interest (for example, the fee simple interest in a plot of land, or a twenty-one-year lease of a flat, or ownership of a painting), grants a subsidiary interest to someone else, S (for example, O grants S a right of way over the plot of land, or sublets the flat to her for five years, or declares he holds the painting on trust for her), but then transfers his own interest to P. In what circumstances will S's interest in the plot of land, the flat and the painting be enforceable against P, so that P holds it subject to S's interest?

Priority questions arise when two or more subsidiary interests are carved out of O's interest, and we need to know which takes priority over the other. The subsidiary interests might all be of the same nature – for example O might first mortgage his fee simple in the plot of land, his lease of his flat and his picture to his Bank B to secure his overdraft of £1 m, but then have a charging order made under the Charging Orders Act 1979 over all three assets to secure a debt of £500,000 he owes to C. If the total value of the three assets is less than £1.5 m, B and C need to know how their interests rank as between themselves. If O fails to repay the two debts, the three assets will have to be sold so that the debts can be paid out of the proceeds of sale, and the person whose interest ranks first will be paid in full before the other is paid anything at all. However, priority questions can also arise where the subsidiary interests are of a different nature and incompatible with each other, like the right of pre-emption and the option to purchase in *Pritchard* v. *Briggs* discussed in see Chapter 12.

A market in property interests can only work effectively if there are effective enforceability and priority rules. Buyers need to know what they are buying, and holders of subsidiary interests need to know how to protect their interests so that they are discoverable by and enforceable against buyers, and not defeated by other incompatible interests arising in the same asset. This demands clear and simple rules that are rigorously applied. If our goal is to increase the marketability of property interests, we need to have, and to apply strictly, rules that lay down

procedures to be followed by those who want to ensure that the assets they buy are not subject to interests they knew nothing about, and by those who want to ensure that their interests are fully protected. Anyone who follows the correct procedure should then be guaranteed that their position will be safeguarded in all circumstances.

However, such a system comes at a heavy price. If the system is to work effectively, an interest holder who does not use the procedure provided to protect his interest should lose the interest, or at least not be able to enforce it against, or take priority over, those who do follow the correct procedures. This may produce a result that is unjust, or disproportionately harsh, on the interest holder. The failure to use the protection machinery might not have been the interest holder's fault: the circumstances might have been such that he could not reasonably have been expected to use it. Alternatively, the consequences of losing his interest might be wholly disproportionate to his fault in not protecting it, and far outweigh the disadvantage the other party would suffer if it had to take subject to the interest. And what about cases where the other party is seeking to rely on the strict letter of the rules in order to take free from an interest it knew about all along? Should the system provide a means of escape for such cases? If not, or if the escape route does not help, should the courts be free to come to a decision that they consider just as between the parties, even at the risk of undermining the integrity of the system?

This is another example of the 'inescapable tension' Birks identifies in Extract 12.1 above. In the context of formalities rules he refers to the clash between two simple principles, one being that that 'you cannot take the advantages of formality and at the same time let off all those who do things in their own informal way', the other being that 'pain should not be inflicted except in case of pressing necessity'. Precisely the same clash occurs in applying the rules we are looking at in this and the next chapter, and as we see in the cases extracted in these two chapters, finding the 'right' balance is just as problematic. Before looking at this in more detail, however, it is necessary to establish what enforceability and priority rules we have in this jurisdiction.

## 14.2. Enforceability and priority rules

### 14.2.1. The basic rules

The basic rules are reasonably straightforward. They apply to all property interests, not just interests in land, and the principle underlying them all is that, once a property interest has come into existence, it should not lightly be set aside in favour of a later interest – in other words, the principle 'first in time is first in right' that we identified in Chapters 7 and 11 as underlying the first possession principle.

In the case of any property interest which is not covered by a registration system, the rules differ depending on whether the interest is legal or equitable. As far as enforceability is concerned, the basic rule is that, if the interest is legal, it is enforceable against the whole world. If it is equitable, it is enforceable against the

whole world, but with two exceptions. First, an equitable interest is not enforceable against someone who can prove that she is a good faith purchaser for value of a legal interest in the asset without notice of the interest holder's interest (sometimes referred to as 'equity's darling'). This is known as the doctrine of notice. Secondly, equitable interests under a trust (and some other types of property interest) are capable of being 'overreached' when the trustee transfers the trust asset to a third party: if such an interest is overreached, it is not enforceable against the transferee. The elements of good faith and notice in the doctrine of notice, and the concept of overreaching, are all crucial here, and we will need to look at them in some detail (see below).

As to priority, legal interests rank for priority purposes according to the date on which they were created. The basic rule is the same for equitable interests, but with two exceptions. First, priority under the basic rule may be forfeited if the court considers that an interest holder's conduct makes it inequitable for him to take priority over a later interest. Primarily this will occur if he allows evidence of his interest to be suppressed so that anyone who later takes an interest in the asset is deceived into believing that there are no prior encumbrances. This requires more than a simple omission by the prior-interest holder to protect his interest by registration (or by whatever other means are available in the circumstances), as we see in *Freeguard* v. *Royal Bank of Scotland plc* (1998) 79 P&CR 81 (discussed in Notes and Questions 14.1 below). However, it is clear from this case that the prior-interest holder's inequitable conduct does not have to be directed at subsequent encumbrancers, whether actual or potential: the prior-interest holder can lose priority even if his motive was to perpetrate a quite different deception on someone entirely different.

The second exception to the basic rule that equitable interests rank by date of creation is that, if there are two or more mortgages or charges over an equitable interest under a trust, priority between them depends on the date on which each mortgagee gives notice of his mortgage to the trustee, except where the later mortgagee had notice of the earlier mortgage. This is known as the rule in *Dearle* v. *Hall* (1823) 3 Russ 1; 38 ER 475; for further details see De Lacy, 'The Priority Rule of Dearle v. Hall Re-stated'.

### 14.2.2. Impact of registration

In an ideal world, a registration system could conceivably have just two rules: interests will be enforceable if but only if they are entered on the register; and interests will take priority from the date of entry on the register. But in the real world such a system is probably not achievable, and arguably not desirable either. Compromises have to be made to draw a balance between conflicting goals of certainty and fairness just as they do in unregistered systems, as we see in the next chapter.

Another real world complication, of more immediate relevance to this chapter, is that, while registration systems usually provide rules about enforceability and

priority of interests in the assets they cover, they do not necessarily apply to *all* interests in those assets. The most common gap is 'off-register' interests or dealings, in other words those that could not have been registered or protected on the register, or could have been but were not. A registration system could provide that all such interests and dealings are simply void for all purposes, and indeed this appears to be the ultimate goal of the Land Registration Act 2002 for all interests other than a strictly limited 'overriding' class, as we see in Chapter 15. However, more commonly, registration systems merely make such interests and dealings ineffective as against purchasers who acquire registered titles or registered interests. This means that the position as between off-register interests has to be governed by general unregistered rules about enforceability and priority. In the case of land registration, the gap is even wider because, broadly, only fee simples, leases, easements, profits and mortgages can actually be registered on the register. All other interests can be 'protected' by entry on the register, which does ensure enforceability against subsequent registered proprietors but does not confer *priority* as against other unregistered interests, whether or not also 'protected' on the register. This is why, in *Freeguard* v. *Royal Bank of Scotland* (1990) 79 P&CR 81 (discussed in Notes and Questions 14.1 below), priority between the option to purchase and the later equitable charge had to be resolved using general equitable priority rules, even though titles to all the land in question were registered under the Land Registration Acts, and even though the later interest, the charge, was protected by an entry on the register.

## Notes and Questions 14.1

Read *Freeguard* v. *Royal Bank of Scotland plc* (1998) 79 P&CR 81, either in full or as extracted at www.cambridge.org/propertylaw/, and consider the following:

1 Whom did the Freeguards intend to deceive or defraud? Who was in fact misled? What does this tell us about the kind of conduct that will cause a prior-interest holder to lose priority to a subsequent encumbrancer?

2 What should the Freeguards have done to protect their interest if they had wanted to ensure that it took priority over all subsequent *equitable* interests? (See section 15.2.4 below.) If the Freeguards had failed to protect their interest simply through ignorance, would it have taken priority over the bank's charge? What could the bank have done to ensure that its charge was not subject to any prior interest it knew nothing about? (See sections 15.2.6 and 15.3 below.)

## 14.3. The doctrine of notice

The category of good faith purchaser of a legal interest without notice is referred to as equity's darling because those who fall within this category are given special

exemption by equity from the fundamental principle that once a property interest comes into existence it should not be set aside in favour of later interests. The doctrine of notice should therefore be seen as a compromise solution, a balance struck between conflicting needs to preserve pre-existing entitlements and to provide the certainty necessary for an efficient market in property interests to operate. This explains the requirement of good faith and the fact that the exemption extends only to purchasers. If the only justification for disturbing pre-existing entitlements is to promote marketability, there is no reason in principle to favour donees (they are not players in the market) nor those who act in bad faith (markets can operate well enough without them). The issue then becomes one of drawing the balance between equitable interest holders and good faith purchasers, often both innocent victims of a fraud or deception perpetrated by a seller who has a pre-existing proprietary relationship with the equitable interest holder.

In *Pilcher* v. *Rawlins* (1871–2) LR 7 Ch App 259 (Extract 14.1 below), the court took the view that, if the good faith purchaser neither knew nor had the means of knowing about the prior equitable interest (i.e. was without notice in the technical sense we consider below), a court of equity had no jurisdiction to interfere with the legal title he had acquired from the seller. The purchaser's conscience was not affected in any way and so equity had no grounds for intervening. But it is worth noting that the court considered that to be the correct outcome not only as a matter of jurisdiction but also as a matter of fairness. If anyone could be said to be at fault here apart from the dishonest trustee, they said, it must be the person who initially chose to enter into an ongoing property relationship with a trustee who turned out to be dishonest, rather than the complete stranger who later comes on the scene.

However, it is clear even from *Pilcher* v. *Rawlins* (and overwhelmingly confirmed by later cases) that the court of equity did not intend the doctrine of notice to be a flexible doctrine, to be applied only after balancing levels of fault on the part of each interest holder in each case. That would largely remove the benefit of certainty of outcome that the rule was indeed to provide. The doctrine of notice is intended to be inflexible, so that purchasers and interest holders know in advance what they need to do in order to safeguard their respective interests. The fairness and effectiveness of the doctrine need to be assessed with this in mind.

### 14.3.1. Notice

This is central to the doctrine. 'Notice' bears a special meaning here. As pointed out in *Pilcher* v. *Rawlins*, it covers not only what the purchaser actually knows (actual notice) but also what he should have known (constructive notice) and what any agent of his knows or ought to have known (imputed notice). The modern formulation appears in section 199(1)(ii) of the Law of Property Act 1925:

(1) A purchaser shall not be prejudicially affected by notice of –

(i) . . .
(ii) any [other] instrument or matter or any fact or thing unless

(a) it is within his own knowledge, or would have come to his knowledge if such inquiries and inspections had been made as ought reasonably to have been made by him; or
(b) in the same transaction with respect to which a question of notice to the purchaser arises, it has come to the knowledge of his counsel, as such, or of his solicitor or other agent, as such, or would have come to the knowledge of his solicitor or other agent, as such, if such inquiries and inspections had been made as ought reasonably to have been made by the solicitor or other agent.

There are two important points to be made about constructive notice. The first is that the nature and extent of the 'inquiries and inspections' that 'ought reasonably to have been made' by the purchaser depend on the particular circumstances of the case, as can be seen from *Kingsnorth Trust Ltd* v. *Tizard* [1986] 1 WLR 783 (extracted at www.cambridge.org/propertylaw/). However, the courts will test what it would have been reasonable for that purchaser to have done by reference to what is regarded as good practice in that sort of situation. This means that, in routine transactions such as buying or taking mortgages over houses, farms, factories or offices, prospective buyers and mortgagees (or, rather, their advisers) know what steps they have to take in order to find out what pre-existing interests affect the premises, and are guaranteed to take free from any interests not revealed by taking those steps. Essentially, they know that, if they carry out a routine investigation of the seller/mortgagor's title and make a physical inspection of the property, they should find out, or at least be alerted to, everything that they will be deemed to know under the doctrine of notice.

Secondly, the question of whether the purchaser had notice of the prior interest is largely objective. Because of the existence of the constructive and imputed categories of notice, the question of what the purchaser actually knew is not usually disputed. Instead, the argument concentrates on an objective inquiry as to what inquiries and inspections ought reasonably to have been made in the circumstances, and what would have been discovered if they had been made. In other words, the purchaser does not have to satisfy the court that he took all reasonable steps to enquire whether there were any encumbrances. He will take free from any that do exist even if he took no steps at all, provided he can satisfy the court that reasonable inquiries and investigations would not have revealed the existence of the interest. This is what the finance house failed to do in *Kingsnorth Trust Ltd* v. *Tizard*: it failed to satisfy the judge that the enquiries and inspections that ought reasonably to have been made *bearing in mind that suspicions ought to have been raised* (i.e. by the discrepancies in what Mr Tizard had said about his marital status in application forms and to the surveyor) would not have revealed the existence of Mrs Tizard's interest in the house.

Occupation has a dual role in the concept of constructive notice as it applies to purchasers and mortgagees of land. There is a general rule, sometimes referred to as the rule in *Hunt* v. *Luck*, that purchasers and mortgagees of land have constructive notice of the interests of anyone who is in occupation of the land (assuming the occupation is reasonably discoverable, as we see in *Kingsnorth Trust Ltd* v. *Tizard*). This is because, as noted above, it is not unnaturally assumed that any reasonable person buying or taking a mortgage over land would actually go and look at it (or at least send an agent), and the presence of someone other than the seller in occupation of the land should alert them to the possibility that the occupier might have rights in the land.

However, although the courts have traditionally seen this as the rationale for the rule in *Hunt* v. *Luck*, this favouring of occupiers over purchasers can also serve to mark the distinction between those who value their interest as thing and those who value it as wealth (adopting Rudden's terminology, as discussed in Extract 2.3 above). In other words, people who have an interest in land that they also occupy are those most likely to regard the monetary value of their interest as an inadequate substitute for the interest itself (consider, for example, the case of Mr and Mrs Flegg in *City of London Building Society* v. *Flegg*, extracted at www.cambridge.org/propertylaw/). Purchasers, on the other hand, can usually be compensated in money terms if they have to take subject to a prior interest. In any case, where the issue is whether a particular interest is enforceable against a particular purchaser or mortgagee, the loser will nearly always be entitled to claim damages from the seller in compensation. Since damages would generally be adequate compensation for a purchaser or mortgagee but inadequate compensation for the prior-interest holder who is in occupation, this provides an additional justification (in theory at least) for a general rule that purchasers and mortgagees take subject to the interests of prior-interest holders in occupation. In practice, in unregistered land this argument has an air of unreality about it because such cases tend to arise where the seller/mortgagor has disappeared or is insolvent, so that there is no prospect of anyone recovering anything from her. However, we return to this argument in Chapter 15 in the context of registered land, where the existence of a state indemnity fund opens up the possibility of alternative ways of compensating the loser.

### 14.3.2. Good faith

In order to take advantage of the doctrine of notice, a purchaser must show not only that he had no notice of the interest but also that he acted in good faith. In *Midland Bank Trust Co. Ltd* v. *Green* [1981] AC 513, Lord Wilberforce confirmed that this requirement is indeed separate from and additional to the requirement that the purchaser must be without notice. In the context in which it was said, it makes sense. Lord Wilberforce was considering whether a requirement of good faith should be imported into the Land Charges Act 1972 so that a purchaser who would otherwise have taken free from a prior interest (i.e. because it was not

registered as required by the Act) would take subject to it if she had acted in bad faith. If such a requirement is imported into a registration scheme, it clearly makes sense to say that the court would have to look at factors going beyond the question of whether the purchaser had notice of the interest, given that the presence of notice does not of itself amount to bad faith, as Lord Wilberforce pointed out. However, in the context of the doctrine of notice itself, it is not clear what it adds. If a purchaser or mortgagor does not have notice of a prior interest, it is difficult to envisage the sort of behaviour or motive on his part that would constitute bad faith *in relation to the prior-interest holder*. Bad faith in relation to anyone or anything else (for example, entering into the transaction in order to evade a tax liability, or to cheat or deceive someone else) surely has no bearing on the question of whether the purchaser should take subject to an interest he knows nothing about, and if he really does know nothing about the prior interest it is difficult to see how he can act in bad faith in relation to it.

### 14.3.3. Effectiveness of the doctrine of notice as an enforceability rule

We saw above that the doctrine of notice is a reasonably fair and effective enforceability rule as far as purchasers are concerned. It performs the channelling function we discussed in section 12.2.7.3 above in relation to formalities rules, in the sense that it provides purchasers with a relatively clear procedure to follow in order to take free from prior interests of which they have no knowledge. Also, if we accept the arguments in *Pilcher* v. *Rawlins* and take into account the incidental effect of the *Hunt* v. *Luck* rule noted above, it draws a reasonably fair balance between the competing interests of prior-interest holder and purchaser.

However, it is marred by a fundamental flaw as far as interest holders are concerned. It provides the interest holder with no sensible means of ensuring that her interest will come to the notice of any subsequent purchaser: if you were Mrs Tizard, what *could* you have done, once you were separated from your husband, to ensure that he did not sell or mortgage the house to a purchaser who would take free from your interest? This is a serious objection. It means that, while the doctrine of notice might provide a reasonably satisfactory way of ordering conflicting interests once a disaster has happened, it gives interest holders no means of ensuring that the disaster never happens in the first place.

#### Extract 14.1 *Pilcher* v. *Rawlins* (1871–2) LR 7 Ch App 259

[This case concerned two frauds perpetrated by W. H. Pilcher (a solicitor and originally one of three trustees of the Jeremiah Pilcher Trust) and Robert Rawlins (the report reveals that he had been a solicitor, but not why he was no longer one). The fraud we are concerned with related to land at Whitchurch. In 1851, Rawlins held the legal fee simple absolute in possession in the Whitchurch land, and he mortgaged it to the trustees of the Jeremiah Pilcher Trust, to secure the payment to the Trust of £8,373 lent to him by the trustees out of the trust fund. This mortgage took the form of a transfer

of the legal fee simple to the trustees, with a proviso that it would be transferred back to Rawlins when he repaid the money (the form that legal mortgages commonly took before 1926).

By 1856, W. H. Pilcher was the sole surviving trustee of the Jeremiah Pilcher Trust, and thus the sole holder of the legal fee simple in the Whitchurch land. In that year, in order to help Rawlins fraudulently obtain money from Stockwell and Lamb (who were trustees of another trust), W. H. Pilcher transferred the legal fee simple in the Whitchurch land back to Rawlins even though Rawlins had not repaid the £8,373 borrowed from the Jeremiah Pilcher Trust. This enabled Rawlins to pretend to Stockwell and Lamb that he held the full legal and equitable interest in the Whitchurch land, free from any mortgage or equitable interest: he was able to convince them of this by showing them all the title deeds of the Whitchurch land including the conveyance by which the legal fee simple was originally vested in him, but suppressing the 1851 mortgage to the Jeremiah Pilcher Trust and the 1856 transfer back by W. H. Pilcher to Rawlins. As a result, Stockwell and Lamb lent Rawlins £10,000 from their trust fund, and to secure repayment of that loan Rawlins purported to mortgage the Whitchurch land to Stockwell and Lamb by transferring the legal fee simple to them, with a proviso that they would transfer it back to him when he repaid the £10,000. The effect of this was to vest the legal fee simple of the Whitchurch land in Stockwell and Lamb: the issue in the case was whether they held subject to or free from the interests of the beneficiaries under the Jeremiah Pilcher Trust. In other words, did Stockwell and Lamb hold the legal fee simple on trust for the Jeremiah Pilcher beneficiaries, or on trust for the Stockwell and Lamb beneficiaries?

The Pilcher beneficiaries brought this action against Rawlins, W. H. Pilcher (who had taken a half share in the £10,000 paid over by Stockwell and Lamb) and Stockwell and Lamb (who, it was accepted, knew nothing of the fraud) to determine this question. The following judgments were given in the Court of Chancery allowing an appeal from the decision of the Master of the Rolls that Stockwell and Lamb held on trust for the Pilcher beneficiaries.]

LORD HATHERLEY, the Lord Chancellor: The defendant Rawlins could not have transferred the legal estate in the property except through the medium of the reconveyance of 1856, and the Master of the Rolls considered the case to be similar in that respect to the case of *Carter* v. *Carter* 3 K&J 617 . . . The case now before us differs in many respects from the case of *Carter* v. *Carter*. An intentional fraud has been committed, and the parties to it have been enabled to effect their purpose owing to the cestuis que trust allowing the trustee, originally one of three, to become the sole trustee. As sole trustee he necessarily had possession of the title deeds to the mortgaged estate; so that, by the reconveyance to the mortgagor, the mortgagor became possessed of the legal estate, and by keeping back the whole mortgage transaction, was enabled to show a complete legal title to the property. Had he disclosed the mortgage, I think that the mortgage deed would have put the parties dealing with him on inquiry; but as matters were conducted, the mortgagee [Stockwell and Lamb] acquired the legal estate and entered into possession of the property without notice of the prior charge, and must, I think, be entitled to hold it.

The plea of purchase without notice states only possession on the part of the professed owner, conveyance of the estate, and absence of notice; and the cases undoubtedly have gone very far ... in showing that, on such a plea, when proved, equity declines all interference with the purchaser, having, as is said, no ground on which it can affect his conscience. I confess that the extent to which this doctrine has been carried was not wholly satisfactory to me when I decided *Carter* v. *Carter* ... [but the] present case is not such a case, and I can therefore concur with the view of the Lord Justices that the decree must be reversed.

SIR W.M. JAMES LJ: I entirely concur in the conclusion to which the Lord Chancellor has arrived ... I propose simply to apply myself to the case of a purchaser for valuable consideration, without notice, obtaining, upon the occasion of his purchase, and by means of his purchase deed, some legal estate, some legal right, some legal advantage; and, according to my view of the established law of this Court, such a purchaser's plea of a purchase for valuable consideration without notice is an absolute, unqualified, unanswerable defence, and an unanswerable plea to the jurisdiction of this Court. Such a purchaser, when he has once put in that plea, may be interrogated and tested to any extent as to the valuable consideration which he has given in order to show the *bona fides* or *mala fides* of his purchase, and also the presence or the absence of notice; but when once he has gone through that ordeal, and has satisfied the terms of the plea of purchase for valuable consideration without notice, then, according to my judgment, this Court has no jurisdiction whatever to do anything more than to let him depart in possession of that legal estate, that legal right, that legal advantage which he has obtained, whatever it may be. In such a case, a purchaser is entitled to hold that which, without any breach of duty, he has had conveyed to him ...

I am therefore of the opinion that, whatever may be the accident by which a purchaser has obtained a good legal title, and in respect of which he has paid his money and is in possession of the property, he is entitled to the benefit of that accident ...

Sir G. MELLISH LJ: I agree in the conclusion to which the Lord Chancellor and the Lord Justice have arrived. I do not think it necessary to give any opinion whether *Carter* v. *Carter* was rightly decided ... But I think that it cannot be supported on the grounds upon which the Master of the Rolls thought it had been decided ... [He], as I understand his judgment, held that a purchaser for valuable consideration, who has obtained a conveyance of the legal estate, is in this Court always to be held to have notice of the contents of the deeds which form a link in the chain by which the legal estate was conveyed to him. And he held that the doctrine of constructive notice ought to be enlarged, and that, although in point of fact the deed in question was never produced to the purchaser – although he had neither knowledge nor the means of knowledge of its contents – although he and his advisers were guilty of no negligence whatever in not obtaining knowledge of its contents – yet, nevertheless, he must in this Court be held to have notice of the contents [of any deed he would need to produce in order to prove his title] ...

The general rule seems to be laid down in the clearest terms by all the great authorities in equity, and has been acted on for a great number of years, namely, that this Court will not take an estate from a purchaser who has bought for valuable

consideration without notice; and I find that [Stockwell and Lamb] are very clearly purchasers for valuable consideration without notice. Unless this doctrine of constructive notice, enlarged as it has been by the Master of the Rolls, is to prevail, I am of opinion that [Stockwell and Lamb] have made out their case.

As it is admitted that, with the exception of what is supposed to have been said in *Carter* v. *Carter*, this rule of constructive notice, as laid down by the Master of the Rolls, has never been established, I will proceed to consider it a little upon principle. It happens, curiously enough, that [Stockwell and Lamb] are themselves trustees for other cestuis que trust, and the question then arises which of the two sets of cestuis que trust are to bear the loss. Is the loss to fall upon the cestuis que trust whose trustee has fraudulently conveyed away the estate which was entrusted to him? Or is the loss to fall upon those whose trustees have honestly taken a conveyance of that estate and who have advanced the money of their cestuis que trust on the faith of that estate which they have really got?

It is surely desirable that the rules of this Court should be in accordance with the ordinary feelings of justice of mankind. Now if the first set of cestuis que trust, those who will unfortunately have to bear the loss, were asked how it happened that they suffered this loss, they would answer that their father conveyed the estates to their uncle, and he turned out to be a dishonest man, and parted with the estate. That is an explanation which any ordinary man of intelligence would understand. It might not be satisfactory to the losers, but they must see at once how it came to happen that they lost their estate. If you trust your property to a man who turns out to be a rogue, it stands to reason that you may lose it. But supposing the Master of the Rolls' doctrine to prevail, and supposing the other cestuis que trust were to be asked how they had lost their property, the answer would be: 'Our trustee invested our property on mortgage on the faith of a person who said that he had the legal estate, and who had it, and who conveyed it to our trustee as a security for the sums advanced, our trustee being guilty of no negligence whatsoever, having taken the advice of a perfectly competent conveyancer in order to see that the title was a good one. But the Court of Chancery says that we have lost it because our trustees had notice of the prior mortgage, though they had, in fact, no notice whatever. They had neither knowledge nor means of knowledge, but nevertheless the Court of Chancery says that, according to its doctrine, they had notice.' The only conclusion which any one would come to is that these cestuis que trust had been deprived of their property by the Court of Chancery, for reasons which, to an ordinary mind, were perfectly incomprehensible.

## Notes and Questions 14.2

Read the above extract and *Kingsnorth Trust Ltd* v. *Tizard* [1986] 1 WLR 783, either in full or as extracted at www.cambridge.org/propertylaw/, and consider the following:

1 Explain why Stockwell and Lamb did not have constructive notice of the interests of the Pilcher beneficiaries, whereas Kingsnorth Trust Ltd did have

constructive notice of Mrs Tizard's interest. What do these two cases tell us about the inquiries and inspections that purchasers and mortgagees are reasonably expected to make?

2 What justifications did the judges give for preferring the claims of the Stockwell and Lamb beneficiaries to those of the Pilcher beneficiaries? Would the decision, or the justifications given for the decision, have been different if Stockwell and Lamb had not been trustees – if, for example, they were commercial moneylenders lending their own money in the course of business? Should it?

3 If, after discovering the fraud, Stockwell and Lamb had then sold the fee simple (as mortgagees are entitled to do) to Rawlins' sister, and she happened to know about the fraud, would Rawlins' sister take subject to or free from the interests of the Pilcher beneficiaries? See *Wilkes* v. *Spooner* [1911] 2 KB 473.

## 14.4. Overreaching

### 14.4.1. Nature and scope of overreaching

There are two ways of describing overreaching. One is to say that it is the process by which interests in land are transferred to the proceeds of sale of the land when the legal title is sold to a purchaser, so that the purchaser takes free from the interest and the equitable interest holder acquires instead an equivalent interest in the proceeds of sale now held by the seller. This is essentially the way in which it was described by Sir Benjamin Cherry, the principal draftsman of the Law of Property Act 1925 which reformulated the pre-existing principle of overreaching. Referring to section 2(1) of the 1925 Act, he said:

> This subsection collects and states the various means by which, where a legal estate in land is affected by any one or more equitable interests or powers, that legal estate can be conveyed to a purchaser in such a way that the purchaser is not concerned with the title to the equitable interest or power, or to obtain the concurrence of the owner thereof. On the other hand, the equitable interest is not defeated or destroyed by the disposition, but is shifted so as to become a corresponding interest or power in or over the proceeds. The conveyance to the purchaser is then said to 'overreach' the equitable interest or power. The expression 'overreach' is not defined in the Act, but this is the sense in which it has been used since 1882. An overreaching conveyance must be distinguished from one which wholly destroys some interest or right, e.g. a conveyance of land affected by a restrictive covenant made after 1925 which is not protected by registration as a land charge.

This was also the view of the Law Commission, implicit in both the Working Paper and the Report on Overreaching which we consider below.

However, overreaching has been described in a radically different way. In *State Bank of India* v. *Sood* [1997] Ch 276 (see below), Peter Gibson LJ adopted the

definition given by Charles Harpum in 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation', namely, that overreaching is merely a process by which pre-existing interests are subordinated to later interests created by dispositions made under a trust. In other words, on this view, contrary to what Cherry says, overreaching is just a means of extinguishing pre-existing interests on a disposition to a purchaser.

If the second is adopted in preference to the first, it has a profound effect on the scope of the doctrine, as we see below. In order to appreciate the significance of the difference, however, it is necessary first to outline how the overreaching machinery provided by the Law of Property Act 1925 operates.

### 14.4.2. Operation of overreaching

Overreaching is not confined to interests under a trust of land, but this is where it most often occurs. Provision for trustees of land to overreach equitable interests generally is made by section 2(1) of the Law of Property Act 1925 (as amended by paragraph 4 of Schedule 3 to the Trusts of Land and Appointment of Trustees Act 1996):

> (1) A conveyance to a purchaser of a legal estate in land shall overreach any equitable interest ... affecting that estate, whether or not he has notice thereof ... (ii) if the conveyance is made by trustees of land and the equitable interest ... is at the date of the conveyance capable of being overreached by such trustees ... and the requirements of section 27 of this Act respecting the payment of capital money arising on such a conveyance are complied with.

A conveyance includes the grant of a mortgage or a lease as well as the transfer of a fee simple (section 205(1)(ii) of the 1925 Act). The requirements of section 27 respecting the payment of capital money which are referred to here are that, notwithstanding anything to the contrary in any instrument creating the trust, 'the proceeds of sale or other capital money' arising out of the conveyance must not be paid to fewer than two persons as trustees of the trust, or to a trust corporation as trustee (section 27(2)).

Section 2(1) refers to equitable interests in general, but section 2(2) and (3) then effectively cut the category of equitable interests that can be overreached down to beneficial interests under trusts, by excluding (among other things) commercial equitable interests such as restrictive covenants, easements, estate contracts and options to purchase (section 2(3)). The significance of this is that overreaching was intended to apply only to interests in land which could properly be represented in money terms, in the sense that an interest in the proceeds of a sale of the land would be an acceptable substitute for an interest in the land itself. This could never be true of commercial interests such as easements or covenants: if an easement or covenant is overreached it is effectively destroyed. At the time of the 1925 legislation, however, it was true of interests under what are now called trusts of land, because they were primarily used as investment devices. If the principal function of the trust fund is to act as an investment for the beneficiaries, it is entirely appropriate

that, when the trustees decide to change the composition of the fund from land to money, the interests of the beneficiaries should automatically transfer from the land to the money and not affect the person purchasing the land from the trustees. Now that trusts of land are more often used as a vehicle for home ownership, the application of overreaching is more problematic, as we see below.

The general effect of section 2(1) is therefore that, when trustees of land sell or mortgage trust land, the interests of the beneficiaries will be overreached and not be enforceable against the purchaser or mortgagee, provided the capital money (the sale proceeds in the case of a sale, and the money lent to the trustees in the case of a mortgage securing that loan) is paid to at least two trustees or a trust corporation. On the face of it, this is an elegant and effective enforceability rule which manages to preserve the value of the prior interests without hindering the marketability of the land. Problems have arisen, however, because money is no longer an adequate substitute for some of the interests to which it applies, and because the decision in *State Bank of India* v. *Sood* [1997] Ch 276 (see below) has both eroded the protection of the two-trustees rule (such as it is) to the disadvantage of prior-interest holders, while at the same time narrowing the range of transactions which can have overreaching effect, to the disadvantage of purchasers. We look at the first of these problems first.

### 14.4.3. Overreaching the interests of occupying beneficiaries

As the Law Commission pointed out in its 1989 report on overreaching, since 1925 there has been a dramatic change in the proportion of dwellings that are owner-occupied, and in the proportion of owner-occupied dwellings that are jointly owned (see Extract 14.2 below). In the case of all the millions of jointly owned owner-occupied dwellings in this country, the property is held on trust and the interests of the beneficiaries are overreachable, and yet, in the vast majority of these cases, the beneficiaries regard themselves as owner-occupiers and not as people who have a purely financial stake in the property. There are therefore significant numbers of beneficiaries for whom the overreaching machinery set up by the 1925 Act, which protects financial interests only, provides inadequate protection. If all the occupying beneficiaries are also trustees, this is of no consequence, because the property cannot be sold or mortgaged without the concurrence of all of them. Similarly, if there is only one trustee (usually because the beneficiary or beneficiaries acquired their interests under a resulting or constructive trust by paying part of the purchase price of the property), this particular problem should not arise because a sale or mortgage by one trustee cannot overreach beneficial interests (although see below as to the extent to which the decision in *State Bank of India* v. *Sood* has undermined this principle). The real problem arises where there are two trustees but they are not also, or not the only, beneficiaries in occupation of the property. In these cases, although as a matter of trust law they should consult the occupying beneficiaries before selling the property (see below), any disposition they make will overreach the beneficiaries' interests whether they do so or not.

In *City of London Building Society* v. *Flegg* [1988] AC 54 (extracted at www.cambridge.org/propertylaw/), the House of Lords was invited to reverse this position and hold that trustees could not overreach the interests of beneficiaries in occupation without their consent. The *Flegg* case provides a good illustration of the fragility of the protection that overreaching provides for beneficiaries. The non-trustee beneficiaries were Mr and Mrs Flegg, who lived in a house, 'Bleak House', with their daughter and son-in law, Mrs and Mr Maxwell-Brown, who held the legal title on trust for the four of them. The overreaching transaction was a mortgage over Bleak House which the Maxwell-Browns granted to the City of London Building Society to secure repayment of a sum of money the building society had lent to the Maxwell-Browns. The effect of the overreaching mechanism was to require the Maxwell-Browns to hold the loan on trust for themselves and the Fleggs. This of itself did not prejudice the financial position of the Fleggs: the effect of the grant of the mortgage was to deplete the value of the Maxwell-Browns' fee simple (still held on trust for themselves and the Fleggs) by an amount precisely equal to the amount of the loan, so the Fleggs' beneficial interest in the loan money compensated them exactly for what they had lost. What caused the Fleggs' loss was the Maxwell-Browns' breaches of trust: the Maxwell-Browns defaulted on repayment of the loan, so entitling the building society to sell the house free from all the beneficial interests, and dissipated the loan money instead of keeping it safe for the Fleggs. The building society was therefore entitled to evict the Fleggs from their home, leaving them with just a personal claim against the Maxwell-Browns (apparently now insolvent and in prison).

The Fleggs' argument was, essentially, that the Maxwell-Browns should not have been able to put their home at risk in this way by mortgaging the fee simple without their consent. Put more precisely, it was argued on their behalf that beneficiaries in occupation of trust land were protected against overreaching without their consent by section 14 of the Law of Property Act 1925. Section 14 provides:

> This Part of this Act shall not prejudicially affect the interest of any person in possession or in actual occupation of land to which he may be entitled in right of such possession or occupation.

On the face of it, this is an attractive argument. The overreaching machinery provided by the Law of Property Act 1925 appears in sections 2 and 27 of the Act, both in 'this Part' of the Act (i.e. Part I). The interests of beneficiaries in occupation of land are prejudicially affected by an overreaching disposition made without their consent if it will deprive them of the benefit of occupation of the land (although see Lord Oliver's response to this point). The last part of the section is admittedly not apt to cover beneficiaries in occupation of the trust land: they do not have an interest in the land 'in right of' (i.e. by virtue of) their occupation. However, none of those who *do* have an interest in land 'in right of' their possession or occupation could conceivably be covered by section 14 (adverse

possessors, for example, are already clearly covered by section 12: see further Notes and Questions 14.3 below). Consequently, so the argument goes, section 14 must be read as *not* limited by these words (i.e. as if the words 'to which he may be entitled in right of such possession or occupation' were omitted) – otherwise section 14 is robbed of all meaning.

However, the House of Lords rejected the argument and held that the Fleggs' interests were overreached by the mortgage to the building society, and consequently the building society was entitled to evict them from their home. They declined the invitation to construe section 14 so as to restrict the overreaching of the interests of beneficiaries in occupation, not so much because of the technical difficulties of construing it in that way, but because of the unlikelihood that it could have been intended, in 1925, to bear such a meaning, and the significant restriction on the operation of the overreaching machinery that would be introduced for the first time if they accepted such a construction.

However, the reaction to the *Flegg* decision prompted the Law Commission, already involved in a reconsideration of the whole of the law relating to trusts of land, to carry out a separate consultation exercise on overreaching. In a Working Paper published in 1988, they canvassed the possibility of reforming the machinery so that either occupying beneficiaries' interests could not be overreached without their consent, or the protection given by the two-trustees rule should be reinforced by requiring at least one of the trustees to be a solicitor or licensed conveyancer. As a result of the consultation exercise, they published a report recommending the former (see Extract 14.2 below).

The trusts of land project was completed and eventually resulted in the enactment of the Trusts of Land and Appointment of Trustees Act 1996, but the recommendations made about overreaching the interests of occupying beneficiaries were never implemented.

### 14.4.4. Transactions capable of overreaching beneficiaries' interests

If, as suggested above, overreaching is indeed the process by which the interests of beneficiaries transfer from land held on trust for them to its proceeds of sale when it is sold or mortgaged by the trustees, it would seem to follow that their interests will not be overreached by a transaction that does not produce proceeds of sale. If a 'sale' or mortgage of trust land by trustees which involves no immediate capital payment by the purchaser/mortgagee to the trustees nevertheless 'overreaches' the beneficial interests under the trust, overreaching means no more than extinguishing, and affords the beneficiaries no protection whatsoever.

In *State Bank of India* v. *Sood* [1997] Ch 276, the Court of Appeal accepted that this would be the effect of allowing beneficial interests to be overreached by transactions which did not produce capital money, but nevertheless held that section 2(1)(ii) of the Law of Property Act 1925 had to be construed to produce this result. In the case itself, two members of the Sood family jointly held the legal title to the house they lived in with five other members of the family. They

mortgaged the house to the bank to secure repayment of money borrowed on overdraft by them and a family company. As usually occurs when a mortgage or charge secures borrowings on overdraft, some of the money had been borrowed before the mortgage was granted and more was borrowed later (i.e. the overdraft increased), but there was no capital sum of money advanced by the bank to the two title holders at the time of the mortgage. The bank called in the overdraft, there was default in repayment and the bank sought possession of the house with a view to enforcing the security. The other five members of the family claimed to have beneficial interests in the house and argued that their interests were not overreached by the mortgage because no capital money had been paid to two trustees. The issue, therefore, was whether section 2 of the Law of Property Act 1925 requires compliance with section 27 of the Act (i.e. payment of capital money to two trustees) *in the case of all dispositions* by the trustees (which would mean that only dispositions for capital money could overreach beneficial interests) or whether section 27 comes into play only in the case of dispositions that do produce capital money. The Court of Appeal said the latter construction was the correct one: overreaching takes place on any *intra vires* disposition by trustees provided that, if capital money arises under the transaction, it is paid to at least two trustees or a trust corporation.

In coming to this decision, the court was persuaded that any other construction would be contrary to the policy of the 1925 legislation. They accepted that trustees may, acting within their powers, enter into transactions which do not produce capital money (for example, an exchange of land, or the grant of a lease without a premium). It must have been the policy of the Act that the beneficial interests under the trust would be overreached by such *intra vires* transactions, and therefore section 2(1)(ii) cannot be read so as to be restricted to transactions producing capital money.

Peter Gibson LJ acknowledged that the result of adopting such a construction was not 'entirely satisfactory'. This understates the difficulties. From the beneficiaries' point of view, the loss of the protection that the overreaching mechanism was intended to supply is significant. Mortgages to secure borrowings on overdraft are not uncommon. Moreover, the decision in *Sood* would seem to extend to allowing such mortgages to overreach beneficial interests even where there is only one trustee. The two-trustees rule appears only in section 27, and if section 27 comes into play only when capital money arises there is nothing left in section 2 to require two trustees for overreaching to take effect. It is true that 'trustees' appears in the plural in the opening words of section 2(1)(ii) but this hardly seems sufficient, given that the use of singulars and plurals is not conclusive in construing statutes (under section 6(c) of the Interpretation Act 1978, words in the plural include the singular, and *vice versa*).

From the point of view of purchasers, the effect of *Sood* is no more satisfactory. In his article, 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation', Charles Harpum argued that transactions by trustees could only overreach the beneficiaries' interests if the transaction was *intra vires*, meaning that the trustees had the power and the authority to enter into. This had never been suggested before

in any of the cases on overreaching, and there are strong policy reasons why it should not be restricted in this way, as we see below. However, in *Sood*, Peter Gibson LJ assumed it to be correct. This is *obiter*, because it was common ground that the mortgage the Soods granted was within their powers. However, if it is correct, it significantly decreases the protection that overreaching provides for purchasers, because it becomes necessary for purchasers to check the authority of the trustees to enter into the transaction. To make matters worse, it is by no means clear which transactions count as authorised for these purposes. In 'The Impact of the Trusts of Land and Appointment of Trustees Act 1996 on Purchasers of Registered Land', Graham Ferris and Graham Battersby argued that the 1996 Act had curtailed trustees' powers for these purposes, but this view has been criticised (Martin Dixon, 'Overreaching and the Trusts of Land and Appointment of Trustees Act 1996'; and see also Ferris and Battersby, 'Overreaching and the Trusts of Land and Appointment of Trustees Act 1996 – A Reply to Mr Dixon'). Also, Ferris and Battersby have subsequently argued persuasively that the Harpum analysis accepted by Peter Gibson LJ in *Sood* is unconvincing in other respects (Ferris and Battersby, 'The General Principles of Overreaching and the Reforms of 1925').

This uncertainty as to the scope of overreaching of course defeats its object. If it is not immediately clear to purchasers on the face of the transaction whether it is one that will overreach beneficial interests, their only safe course is to enquire into the details of the trust in all cases, which was precisely what the 1925 legislation was seeking to avoid.

### 14.4.5. The two-trustees rule

A final word needs to be said about the effectiveness of the two-trustees rule. It was introduced by the 1925 legislation on the basis, as the Law Commission put it, that 'two heads (containing consciences as well as brains) ought to be better than one' (Law Commission, *Trusts of Land: Overreaching* (Law Commission Consultative Document No. 106, 1988), paragraph 3.1). In that working paper, the Law Commission invited views on whether this was the best method of providing protection to beneficiaries, or whether perhaps the safeguard should be strengthened to require one of the trustees to be a solicitor. However, there was little support for change on consultation, and the Law Commission concluded that the added complications in conveyancing that would be caused by such a change outweighed any benefits (see Extract 14.2 below). Consequently, the two-trustees rule remains.

**Extract 14.2 Law Commission, *Transfer of Land: Overreaching: Beneficiaries in Occupation* (Law Commission Report No. 188, 1989)**

PART II THE PRESENT LAW

*Introductory*

2.1. It is an established, flexible and convenient feature of English land law that property can be legally owned by trustees, who hold it on behalf of one or more beneficiaries. The

nature of the beneficiaries' interests can vary widely, as indeed can the degree of formality with which they are created. The fact that the law can accommodate many different and separate ownership interests in the same property, whether they are concurrent or consecutive, gives owners the chance to deal with their property in almost any way they choose. It can, however, present real problems when the land comes to be disposed of – a purchaser needs to be assured that he is acquiring the whole of the interest for which he contracted. If that interest has been fragmented, proving title can be complicated, costly and time-consuming. 'The central dilemma of land law is how to reconcile security of title with ease of transfer.'[1]

2.2. This dilemma was tackled in the property legislation of 1925, because before 1926 'the purchaser had to examine the lengthy, and, for this purpose, mainly irrelevant, provisions of the settlement in order to discover the principal facts essential to his obtaining a good title ... To discover these facts was often a tedious task, for the settlement was a long document setting out the trusts in full and a purchaser often had to waste time in reading clauses which were of no interest to him in order to ascertain a few simple facts. There were corresponding inconveniences to the beneficiaries and trustees.'[2] The 1925 legislation effected a compromise by making land held in trust freely marketable, while preserving the interests of the beneficiaries under those trusts, by the device of overreaching, which had originally been developed by conveyancing practitioners in connection with express trusts for sale, as a means of keeping the equities off the legal title.

...

2.6. In recent years there has been a sharp increase in the number of married couples acquiring their matrimonial homes and other property in joint names.[3][9] Commercial property owned by partnerships is normally also held in this way. In every case, the legal owners are technically trustees, even if they are themselves the beneficiaries for whom they hold the land.

2.7. At the same time, as the incidence of ownership by more than one person has increased, the concept of equitable interests arising informally has been developed. So, where two people contribute to the purchase price of the property which is then conveyed into the name of only one of them, both contributors are equitable tenants in common.[4][10] The contribution which entitles someone to a share of the property in equity may be made after the purchase. In one case, where an agreement to share could be implied and one member of a couple who were living together did a great deal of physical work to a property belonging to the other, she was held to have an equitable interest.[5][11] The claimant has to demonstrate a common intention that, even if he did not contribute to the purchase price, he and the legal owner should both have beneficial interests in the property and that he acted to his detriment on the basis of that intention, believing he would acquire a beneficial interest.[6][12]

1 Megarry and Wade, *The Law of Real Property*, 5th ed. (1984), p. 141. 2 *Ibid*., p. 327.
3 Fifty-one per cent of all owner-occupied homes bought in 1960–1 were purchased in joint names; in 1970–1, the equivalent figure was 74 per cent (source: Todd and Jones, *Matrimonial Property* (1972). p. 80). Experience suggests that this increasing trend has continued.
4 *Bull* v. *Bull* [1955] 1 QB 234. 5 *Eves* v. *Eves* [1975] 1 WLR 1338.
6 *Grant* v. *Edwards* [1986] Ch 638.

2.8. Although the courts consider these circumstances most frequently in relation to living accommodation, the rules affect all types of property for whatever purpose it is owned ...

*Overreaching*

2.9. One of the main objectives of the 1925 property legislation was to simplify conveyancing and the proof of title to land, by separating legal and equitable interests. The aim was to permit dealings with legal estates without reference to, or even in ignorance of, the equitable beneficial interests. There was no intention to defeat the interests of trust beneficiaries, but rather to ensure that they become rights against whatever was for the time being subject to the trust, without hampering the ability of trustees to dispose of any property. This was achieved by 'the principle of "overreaching" by which equitable interests such as the interest of the beneficiaries under trusts are kept off the title to the legal estate, and are overreached on the sale of the legal estate to a purchaser who accordingly takes free of them'.[7][16] On a sale, e.g. the beneficiary's claims are transferred to the proceeds of sale, but only if the money is paid to two trustees or a trust corporation.[8][17]

...

*Safeguard for beneficiaries*

2.18. Clearly, any beneficiary whose interest is overreached needs to be reassured that his position has not been prejudiced. His safeguard is, in the majority of cases, directions as to payment of the consideration for which the legal estate is sold.[9][48] On a sale ... by a trustee for sale, the money must be paid to or applied by the direction of at least two persons as trustees for sale ... or a trust corporation ... If the appropriate requirement for payment is not fulfilled, there is no overreaching.

2.19. The requirement to pay capital money to two trustees or a trust corporation was newly introduced by the 1925 legislation. 'The safeguard against mistake or fraud of having at least two trustees or a trust corporation where capital money falls to be received, is a fairly obvious reform; it became essential when additional powers ... to overreach equitable interests were conferred.'[10][50] That comment, in the early years after the 1925 legislation, may be seen as over-optimistic about the strength of the safeguard for beneficiaries. In a recent case, a couple bought a house to accommodate themselves and the wife's parents and all contributed to the cost of it. A mortgage by the legal owners *pro tanto* overreached the older couple's interest, and on the mortgagors' default the mortgagee's claims took priority.[11][51]

2.20. In the case of a statutory trust for sale, the trustees must so far as practicable consult the beneficiaries of full age before selling. They must give effect to the wishes of

7 Parker and Mellows, *Modern Law of Trusts*, 5th ed. (1983), p. 5.
8 Paras. 2.18–2.19 below. A trust corporation means the Public Trustee, a corporation appointed by the court to act as trustee in a particular case, or a corporation entitled to act as a custodian trustee under the rules made pursuant to the Public Trustee Act 1906, section 4; Law of Property Act 1925, section 205(1)(xxviii).
9 Law of Property Act 1925, section 2(1), (2); Settled Land Act 1925, sections 72(1), 94(1).
10 Wolstenholme and Cherry, *Conveyancing Statutes*, 12th ed. (1932), p. 268.
11 *City of London Building Society* v. *Flegg* [1988] AC 54.

the beneficiaries, or of the majority of them, so far as consistent with the general interests of the trust. However, a purchaser is not concerned to see that the trustees have complied, so a sale without the beneficiaries having been consulted, or in defiance of their wishes, is valid[12][52] ...

## PART III NEED FOR REFORM

*Change of circumstances*

3.1. The 1925 legislation compromise between the need to protect beneficiaries under trusts of land and the demand for certainty and simplicity in conveyancing was satisfactory, and perhaps ideal, in the circumstances in which it was intended to operate. A purchaser from trustees could ignore the beneficial interests so long as he was careful to observe simple precautions in paying the price. This successfully hid the terms of the settlement 'behind the curtain'. Buying from trustees became as simple as buying from a single beneficial legal owner which it certainly had not been previously. At the same time, the financial interest of the beneficiary was safeguarded by transferring his claim to the proceeds of sale. So long as the trustees properly conducted the affairs of the settlement, it was not important to the beneficiary by what assets his interest was secured.

3.2. Doubts about these provisions arise now because, over the years, the patterns of land ownership and the use of settlements have changed. Although the rules with which we are concerned affect all types of real property, the changes relating to residential property are most significant. Since 1925, both the number of dwellings in England and Wales and the percentage of them which are owner-occupied have jumped dramatically.[13][3] Couples have increasingly bought owner-occupied housing in their joint names, and this trend was accelerated by the decision in *Williams & Glyn's Bank Ltd* v. *Boland* [1981] AC 487 following which lending institutions encouraged borrowers to buy jointly so that they, the institutions, had the advantage of the statutory overreaching rules. These couples are technically trustees for sale, whether they hold on trust only for themselves, as is often the case, or whether there are others with beneficial interests.

3.3. For this reason, there is now a very large number of cases in which trust beneficiaries occupy trust property as their homes. Sometimes, also, the trust property is where they carry on business. Generally, the trust is a conveyancing technicality, imposed by the Law of Property Act 1925 as part of the scheme to confine normal conveyancing to legal estates. Most individuals in this position would be surprised to hear themselves referred to as trustees or as beneficiaries; they regard themselves

12 Law of Property Act 1925, section 26(3).

13 Statistics are not available for 1926 (the year in which the 1925 legislation came into effect). In 1931, there were 9.4 m dwellings in England and Wales (source: Census of England and Wales 1931), compared with 20.35 m in 1988 (source: Housing and Construction Statistics). The proportion of dwellings which were owner-occupied was 11.24 per cent in 1914, 32.46 per cent in 1938 and 67.19 per cent in 1988 (source: Department of the Environment). There are therefore about 6.5 times as many owner-occupied dwellings now as there were when the 1925 legislation came into force.

simply as joint owners. The changes in circumstances have exposed the 1925 rules for the device which they are. 'If the framers of the property legislation in 1925 had been able to foresee the growth in joint ownership of property which, coupled with the vast increase in the breakdown of marriage,[14][6] has exposed the artificiality of the statutory trust for sale, they might have made clearer provision for the protection of beneficial interests without widening the enquiries needed to be made by a purchaser.'[15][7]

*Protecting occupation of property*

3.4. In our working paper we said, 'we are not in this exercise primarily concerned with protecting beneficiaries' financial interests. It is their prospect of enjoyment of the land itself and its loss where overreaching occurs upon which we wish to focus.'[16][8] Some of those who responded agreed with this view. One correspondent said, 'I do not think it right that people in actual occupation of property should be in peril of losing their home as a result of the overreaching process.' Another pointed out that 'almost all other occupiers [of residential property] have some protection from arbitrary eviction'.

3.5. We remain of the view that reform is required here. There are four main reasons. First, the exclusively financial protection given by the 1925 legislation is no longer appropriate for occupiers of their own homes; their real concern is often with the enjoyment of the property itself which will be lost after overreaching. Secondly, as the general understanding of many of the beneficiaries with whom we are concerned is that they are joint owners, they should have appropriate ownership rights. There is scant justification for the law giving preference to the wishes of one joint owner over those of another, simply because the former was constituted trustee of the legal estate. Thirdly, it is unsatisfactory that the consequences which a sale visits upon a beneficiary in occupation are different depending whether the legal estate happens to have been vested in one, or in more than one, person. Fourthly, it is difficult to defend the situation in which someone not married to the legal owner in actual occupation of their home, and in which they own a share, has less right to remain there than a husband or wife without any such ownership interest.[17][9]

3.6. Accordingly, we reject one possible option which we put forward in the working paper, do nothing.[18][10]

3.7. In seeking a solution, we nevertheless recognise the importance of avoiding unnecessary complications in conveyancing. As we pointed out, 'it is important not to lose sight of the advantages for the public in facilitating reasonably speedy and safe conveyancing'.[19][11] This point was emphasised by many of the respondents to the working paper, who were practical conveyancers. One solicitor wrote, 'it would not be

14 Between 1961 and 1986 the divorce rate rose from 2.1 per 1,000 married people to 12.9 per 1,000: see *Facing the Future: A Discussion Paper on the Ground for Divorce* (1988), Law Com. No. 170, Appendix A.
15 Ruoff and Roper, *Law and Practice of Registered Conveyancing*, 5th ed. (1986), p. 822.
16 Working Paper, para. 6.1.
17 The non-owning spouse has occupation rights under Matrimonial Homes Act 1983, s. 1(11).
18 Working Paper, para. 6.14. 19 Working Paper, para. 6.2.

appropriate for anything to be put forward that would have the effect of making conveyancing more difficult and/or expensive'.

3.8. Another reform option would be to require beneficiaries, who wanted to be consulted before the property was disposed of, to register their interests. The corollary to this would be that in the absence of registration overreaching would apply without the beneficiary having any right to withhold consent.[20][12] We commented, 'this proposal can be rejected as being both complex and unrealistic'.[21][13] It did, nevertheless, attract limited support. One firm of solicitors considered 'that requiring an occupying beneficiary to register his interest produces a degree of certainty as to who has such an interest'. However, we agree with the academic lawyer who said, 'The real problem is the case of the casual contributor, who is unaware of the need to protect his or her position.' Several Mothers' Union groups suggested that 'since few beneficiaries would anticipate difficulties later on, they would not themselves take the necessary action'. This is the nub of the difficulty in this approach to reform. The objective must be to confer greater rights on those whom fairness dictates should have them. To do so in such a way that the procedural requirements will defeat the claims of many who are intended to benefit is not a satisfactory way forward. We do not doubt that a lot of people whose ownership interests derive from contributing to the purchase price of a property or from spending money on improvements would fail to register their claims, because they would not know of the need to do so.

3.9. Nevertheless, the need to alert purchasers and others interested in the property remains, and efficient conveyancing demands that beneficiaries' interests can be readily discovered. In our view, the very fact of a beneficiary's occupation of the property will provide a sufficient, although not an infallible, advance warning that he may have an interest, so that appropriate enquiries can be made. This is already the case for registered land,[22][14] and it is what in practice alerts people to the existence of beneficial interests which will not be overreached.[23][15] We therefore consider that there is no need for beneficiaries to be required to take further steps, and our principal recommendation, set out in Part IV,[24][16] is made on that basis.

## PART IV REFORM PROPOSALS

### *Principal recommendation*

4.1. We have concluded that the present protection of the interests of equitable owners in occupation of property is, in some circumstances, inadequate. The owner of an equitable interest which carries a right of occupation is entitled to two distinct benefits: a right to the value of the interest and the right to enjoy occupation. When the owner of a legal estate is in a similar position, the law protects each right separately; if the owner opts to remain in possession, he cannot be obliged to rely solely on the alternative financial right. The effect of overreaching is, however, to oblige the equitable owner to surrender his occupation

20 Working Paper, para. 6.3. 21 Working Paper, para. 6.4. 22 See para. 2.21 above.
23 By virtue of *Williams & Glyn's Bank Ltd* v. *Boland* [1981] AC 487; para. 2.22 above.
24 Para. 4.3 below.

right in favour of his financial one, without the chance to make a choice. We see no reason why equitable owners should be at a disadvantage in this respect.

4.2. We are, however, conscious of the need to maintain arrangements which will not unduly interfere with conveyancing. This leads us to place our emphasis on protecting the rights of owners of equitable interests who are in actual occupation of the property. That very fact of occupation can be used to alert prospective purchasers and mortgagees to the claims of the equitable owners. It means that the protection of occupation rights does not extend to those who, while they are entitled to occupy, are not currently exercising the right. While that means that equitable owners will sometimes be at a disadvantage, when compared with legal owners, it seems to us to be a reasonable compromise. It offers the right to continue in occupation, to those who are already there, so it is likely to extend the new protection to those who most need it, and of course protection extends to those who enter later.

4.3. Our principal recommendation, to protect the occupation rights of those with an equitable interest in property, can be succinctly stated:

> A conveyance of a legal estate in property should not have the effect of overreaching the interest of anyone of full age and capacity who is entitled to a beneficial interest in the property and who has a right to occupy it and is in actual occupation of it at the date of the conveyance, unless that person consents.

## Notes and Questions 14.3

Read the above extract and *City of London Building Society* v. *Flegg* [1988] AC 54 and *State Bank of India* v. *Sood* [1997] Ch 276, either in full or as extracted at www.cambridge.org/propertylaw/, and consider the following:

1 The statutory provisions about trustees' duties to consult beneficiaries and act in accordance with their wishes now appear in the Trusts of Land and Appointment of Trustees Act 1996. For an analysis of the effect of these changes on overreaching powers, see Harpum, 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation'; Ferris and Battersby, 'The Impact of the Trusts of Land and Appointment of Trustees Act 1996 on Purchasers of Registered Land'; Dixon, 'Overreaching and the Trusts of Land and Appointment of Trustees Act 1996'; Ferris and Battersby, 'Overreaching and the Trusts of Land and Appointment of Trustees Act 1996 – A Reply to Mr Dixon'; Ferris and Battersby, 'The General Principles of Overreaching and the Reforms of 1925'.

2 Explain why the House of Lords in *Flegg* refused to accept the interpretation of section 14 of the Law of Property Act 1925 put forward on behalf of the Fleggs. What does section 14 mean?

3 Why was 'Bleak House' not put in the joint names of the Fleggs and the Maxwell-Browns? Is this a relevant factor in considering whether the Fleggs' interests should be overreachable without their consent?

4 In *Sood*, counsel for the beneficiaries conceded that, even on their construction of section 2(1)(ii) of the 1925 Act, the interests would be overreached if even a tiny proportion of the total sum borrowed had been advanced at the time of the mortgage, and this conclusion appears inescapable on the wording of the section. The truth probably is that the draftsmen did not have in mind transactions where the consideration was to paid at a later date, whether by instalments of rent or staged payments of capital. Consider how, if at all, they could have adapted the overreaching machinery in section 2 to cover such payments.

5 Are beneficiaries better off or worse off as a result of the decision in *Sood*? What about purchasers?

6 Discuss whether the law should be changed so that overreaching could not take place without the consent of beneficiaries in occupation of trust property. Could this operate to the disadvantage of other beneficiaries?

7 Write a paper addressed to the government either putting forward proposals for the reform of the law of overreaching or recommending that no changes should be made.