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Daniel Lewis examines Court of Appeal guidance on the law governing the limitation period in mortgage shortfall claims

In the early 1990s, a combination of economic factors meant many borrowers became unable to meet the payments on their mortgages and defaulted. The lenders found that in many cases the sale price of the property was insufficient to recoup the amount owed. Left with a shortfall on the debt, it was open to mortgagees to bring a claim against the mortgagors for the difference between the sale price and the amount owed. Often the claim for the shortfall was not issued until after a long delay and in some cases not until the beginning of this decade.

The Court of Appeal has considered the limitation period for such claims three times: in *Bristol and West plc v Bartlett* [2003] 1 WLR 284; *Scottish Equitable plc v Thompson* [2003] EWCA 225; and, most recently, in *Wilkinson v West Bromwich Building Society* [2004] EWCA 1063; (2004) 148 SJ 975. In all three cases the mortgagees had repossessed and sold the mortgaged property in the early 1990s and now sought the shortfall from the borrowers.

Section 5, 8 or 20?

That there should have been doubt as to the relevant section of the Limitation Act 1980 to apply in shortfall claims is surprising given the clear wording of s 20(1):

"No action shall be brought to recover:

(a) any principal sum of money secured by a mortgage

(b) or other charge on property (whether real or personal) … after 12 years from the date on which the right to receive the money accrued."

Doubts as to the applicability of s 20 were raised because a claim for the shortfall between the mortgage debt and the proceeds of sale of the mortgaged property was not, strictly speaking, an action brought to recover "any principal sum of money secured by a mortgage or other charge on property". As the mortgagee has already exercised the power of sale at the time the claim is brought, the remaining debt is no longer secured on property. In *Hopkinson v Tupper* (unrep, 30 January 1997), a strike-out application, Auld LJ said:

"[I]t is seriously arguable that where a mortgagee has re-possessed and has sold the security and is seeking to recover the shortfall, his claim is in simple contract whatever the nature of the instrument under which the debt was initially secured … It seems to me … at least neither s 20(1) nor (5) governs the matter and that the whole claim was one in simple contract to which limitation period applies."

His words were relied upon by mortgagors in a number of subsequent cases. The

possibility these claims might be governed by s 5 of the Limitation Act 1980, which applies a six-year limitation period, caused some considerable concern to banks and lenders, who had previously assumed that s 8 (an action on a specialty) or s 20 applied. The Court of Appeal in *Bartlett* provided a definitive answer as to which provision of the Limitation Act 1980 applied.

In *Bartlett*, the borrowers argued that the six-year limitation period should apply for two reasons, both based on the decision in *Hopkinson*. They argued that when the mortgage was discharged as a result of the mortgagee exercising its power of sale, the covenant to pay in the mortgage deed became unenforceable or was discharged. All that remained was an 'implied obligation' which was subject to a six-year limitation period under s 5.

These arguments did not find favour with the Court of Appeal. Longmore LJ held that the mortgage debt remained payable to the lender after the power of sale. It would be "extraordinary" if the parties were to have contracted that "accrued rights were to be wiped out". There was no basis for construing the mortgage deed so as to wipe out express accrued obligations and replace them with implied obligations (for which a different limitation period applied). Dismissing the borrowers' appeal, he held that the simple contract argument advanced in *Hopkinson* was not sustainable in the light of fuller argument and citation of authority.

The Court of Appeal then considered whether ss 8 or 20 apply to shortfall claims, although as both sections impose a 12-year limitation period, the determination of the issue was largely academic, at least as far as the claim for the principal was concerned. The court held that s 20 applied, as at the time the mortgagee's cause of action to recover money secured by a mortgage and that nothing that happened thereafter could change that.

Date of accrual of cause of action

Section 20 provides that the cause of action will accrue on the date that "the right to receive the money accrued". The right to receive the mortgage debt will usually be provided for in the mortgage terms, typically upon default in the payment of instalments and after a demand is made by the mortgagee. The cause of action will accrue on the date that such a demand was made. Alternatively, the mortgage conditions may provide that the mortgage debt shall, without any demand having been made, become immediately due and payable upon certain events (eg, the mortgagee commencing proceedings to enforce the security). In this case the cause of action will accrue at the time the 'trigger event' occurred. Where the mortgage conditions contain competing terms, the earliest date will prevail.

In *Thompson*, the somewhat unusual mortgage conditions did not contain an express covenant for repayment of the principal sum, nor did they specify any particular event for repayment by reference to a date, or to some act or omission of the borrower. Applying *Bartlett*, the Court of Appeal held that the applicable provision was s 20 of the Limitation Act 1980. As to the date of accrual, in the absence of specific provision in the mortgage conditions, it was submitted on behalf of the

mortgagee that the cause of action accrued on the date a demand was made. On the facts it was argued that the demand had been made on the date proceedings were issued, although counsel for the mortgagee also put forward a number of other dates upon which the cause of action could have accrued. Mummery LJ declined to determine the precise date of accrual, save that it was within the period 12 years prior to the issue of proceedings.

Re-accrual of cause of action

A number of lenders have taken the view that while the cause of action accrues under their mortgage conditions prior to the sale of the mortgaged property, the cause of action will accrue afresh upon receipt of the proceeds of sale.

In *UCB Corporate Services Ltd v Kohli* [2004] EWHC 1126, the claim was brought for sums due under a guarantee entered into by the defendant to secure the advances provided by the claimant to a company, Crowngate Hotels Ltd, of which the defendant was a director. As the guarantee was in the form of a deed, the claim under the guarantee was an action upon a specialty, and it was therefore common ground that s 8 of the Limitation Act 1980 applied. The claimant advanced two arguments that might equally apply in a mortgage shortfall claim:

(1) The cause of action did not arise until the loss had been ascertained, ie, once the claimant had taken possession of and sold the charged property. Only once the receipts from this sale were applied to Crowngate's account was the extent of the debt under the guarantee ascertained. Richard Sheldon QC, sitting as a deputy High Court judge, held that the cause of action against the defendant accrued at the time the claimant was entitled to payment of the entire debt from Crowngate.

(2) The receipt of the proceeds of sale had the effect that the cause of action re-accrued under s 29(5) of the Limitation Act 1980, which provides that the cause of action will be treated as accruing on the date of acknowledgement or payment by the person liable for the claim.

Sheldon QC held that there was no re-accrual of the cause of action on receipt of the proceeds of sale of the charged property. The credit entry in the account represented no more than the mortgagee in possession accounting to the mortgagor for rents and profits during his possession. This payment could not therefore be accurately described as a payment by Crowngate as the person liable or accountable for the claim within the meaning of s 29(5), nor could the mortgagee (or receivers, if appointed) be considered agents of the mortgagor. Accordingly, the claim was time-barred and the proceeds received by the claimant did not cause the limitation period to start afresh.

Limitation of claims for interest

A substantial element of any claim for a mortgage shortfall where limitation arguments are raised will be the interest accruing on the remaining mortgage debt. Section 20(5) provides:

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

In *Bartlett*, the Court of Appeal did not hear argument on the question of interest and did not provide detailed guidance as to the application of s 20(5). In *Thompson*, the Court of Appeal held that under s 20(5) the lender was entitled to recover the interest falling due in the six years prior to the issue of proceedings.

In a claim for the mortgage principal, the lender may claim statutory interest under s 69 of the County Courts Act 1984 or s 35A of the Supreme Court Act 1981. In *Wilkinson*, the lender claimed statutory interest on the mortgage shortfall after sale at 8 per cent pa from the date of sale. In proceedings below it was held that the lender's entitlement was limited to three years from the date of sale. It was not granted for the entire period "on the ground that there had been an unexplained failure by the Society to bring proceedings within a reasonable time". The Court of Appeal held that the claim for the principal was statute-barred. As a result, the Society's appeal against the decision that the interest should be limited to three years did not fall to be decided. However, in his judgment, Mummery LJ said:

"[counsel for the Society] submitted that the judge had failed to take into account the windfall to the Wilkinsons in not paying the Society the sums due to them as soon as they became payable and that it was wrong to deny the Society the interest for the whole of the period since the sale of the house. I would not regard these arguments as justifying interference by this court with the judge's discretion under s 35A of the Supreme Court Act 1981."

Therefore, while the lender may have a claim to statutory interest from the date of sale, where there has been culpable delay on the part of the lender in bringing proceedings promptly, any award of interest may be reduced (either by reference to the period for which the award of interest is allowed, or by a reduction in the rate).

The lender may be able to reduce the effect of s 20(5) and claim interest for up to 12 years by arguing that payments received (eg, the proceeds of sale) have been appropriated to discharge outstanding interest rather than the principal. There is a general presumption that, in the absence of an express appropriation to either interest or principal by the lender or the debtor, payments will be applied to interest first.

If the mortgage terms contain a capitalisation provision, the mortgagee will be entitled to interest for the whole 12 years. In *West Bromwich Building Society v Crammer* [2003] BPIR 783, Neuberger J held that the effect of such a provision was that unpaid interest was added to the principal, so that a 12-year limitation period applied. The disadvantage to the mortgagee of a capitalisation provision is that, if the claim to the principal sum is statute-barred, the claim to interest will also fail.

Conclusion

Once the limitation defence has been raised by the borrower, the evidential burden transfers to the lender to demonstrate that proceedings were issued within the limitation period. Given that recollections on both sides of events that occurred over 12 years ago may be unclear, it may be difficult to obtain the precise factual instructions needed to raise or rebut the limitation defence. Following *Bartlett*, *Thompson* and *Wilkinson*, those advising parties to a

mortgage shortfall claim at least have the advantage of clear guidance as to the law.

Postscript:

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