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Daniel Lewis examines the law governing the limitation period in mortgage shortfall claims and recent cases

The volume of mortgage shortfall claims in which limitation may be raised as a defence shows little sign of abating. In part this is due to the economic conditions that persisted until the mid-1990s. Borrowers who were unable to meet the payments on their mortgages and defaulted found that the proceeds from the sale of the property were insufficient to discharge the mortgage debt. An action for the mortgage shortfall at this time would have been unlikely to realise any substantial sums, so that in many cases lenders chose to wait or to assign the debt and as a result proceedings were not brought until after a substantial delay. The second factor encouraging a large amount of litigation in this area has been uncertainty as to the application of the Limitation Act 1980 to these claims. This uncertainty has prompted borrowers and lenders to raise arguments as to the applicable sections of the Act, the date upon which the cause of action is deemed to have accrued, and as to whether certain conduct amounts to an acknowledgment or payment in respect of the mortgage debt so that the cause of action re-accrues at a later date.

Those advising parties to a mortgage shortfall claim now have the benefit of the House of Lords' decision in *West Bromwich Building Society v Wilkinson* [2005] 1 WLR 2303, which provides authoritative guidance on the application of the Limitation Act 1980. However, while this case resolves many of the fundamental questions, much will still depend upon the construction of specific mortgage terms and in particular the date upon which the cause of action is deemed to have accrued. In addition, on the issue of re-accrual, the Court of Appeal has recently considered whether pre-action correspondence from the borrower amounts to an acknowledgment of the mortgage debt in *Bradford and Bingley plc v Rashid* [2005] EWCA 1080.

Section 5, 8 or 20?

Before the decision of the Court of Appeal in *Bristol and West plc v Bartlett* [2003] 1 WLR 284, a great deal of argument was expended on whether s 5 (a claim in simple contract), s 8 (an action on a specialty) or s 20 (an action for a principal sum of money secured by a mortgage) applied in mortgage shortfall claims. In *Bartlett*, Longmore LJ held that s 20 applied as the mortgage was in existence on the date on which the cause of action accrued and this approach was affirmed in *Wilkinson*, Lord Hoffmann concluding:

"If, therefore, the cause of action when it arose was a claim to a debt secured on a mortgage, I do not think s 20 ceases to apply when the security is subsequently realised."

Section 20(1) itself provides:

"No action shall be brought to recover–

(a) any principal sum of money secured by a mortgage or other charge on property (whether real or personal)… after the expiration of 12 years **from the date on**

which the right to receive the money accrued." (emphasis added)

It is now beyond argument that this section will apply, although there may, depending upon the terms of the mortgage, be rather more uncertainty as to how the date upon which "the right to receive the money accrued" is to be calculated.

Accrual of the 'right to receive'

The date upon which the right to receive the money accrued will be determined by the construction of the mortgage deed, and in particular when the covenant to repay the whole of the mortgage debt was triggered. Broadly speaking, the covenant to repay in mortgage terms takes one of two forms. The mortgage may either provide that the monies are repayable 'upon demand' or that they become 'immediately repayable' upon a particular event (for instance, the borrower falling two months behind on repayments). In the latter case, it is usually a straightforward matter of ascertaining when the borrower was in default by examining the mortgage accounts. However, where there is an 'upon demand' term, the lender may postpone making a demand for the mortgage debt and contend that time only begins to run after a formal demand is made which may be made some considerable time after the mortgaged property was sold and the shortfall ascertained. This argument was advanced, in the absence of an 'immediately repayable' covenant in the mortgage terms by the lender in *Scottish Equitable plc v Thompson* [2003] EWCA 225, although the Court of Appeal did not make any finding on the issue as, on any view of the date of accrual, the claim was not statute-barred.

In *Wilkinson*, the House of Lords considered terms which provided that the power of sale (under s 101 of the Law of Property Act 1925) would become exercisable upon the occurrence of one of a number of particular events, including the borrower becoming more than one month in arrears or a demand for payment being made. As to when the mortgage principal became due, the mortgage terms were silent. It was contended on behalf of the building society that upon default the only claim that they could make against the mortgagor would be a claim for each monthly repayment as it fell due.

This would produce what Lord Hoffmann described as "a very odd result". The lender would be entitled to sell the property, discharge any outstanding payments from the proceeds of sale, and hold the remainder of the proceeds as substituted security to set against subsequent payments as they became due. The practical effect would be that the "right to receive" the monies would accrue at a later date, and after the sale of the property. There would be a separate limitation period of 12 years for each instalment, which would only accrue at such time as the proceeds of sale were exhausted.

This argument did not find favour with the House of Lords. The mortgage terms provided that the power of sale was exercisable upon a demand being made. In exercising the power of sale under s 101 of the 1925 Act, the mortgage money must have "become due", as otherwise the statutory power of sale is not exercisable. Accordingly, upon making the demand which was a necessary pre-cursor to the exercise of the statutory power of sale, the mortgage principal also became due and payable at this time. To interpret

the making of the demand only as an event that made the power of sale exercisable and had no effect on whether the mortgage principal itself was due, would mean that a demand might be made when the borrower was not actually obliged to pay the money.

To a certain extent the decision in *Wilkinson* turns upon the construction of a particular and unusual mortgage deed, which made no provision as to the repayment of the mortgage principal. However, this decision also provides some guidance as to the application of s 20 to those more common cases where the terms provide that the mortgage monies become payable 'upon demand'.

The 'upon demand' covenant

Where under the mortgage terms the principal only becomes repayable 'upon demand', lenders frequently rely upon a recent demand for repayment as the date of accrual of the right to receive the mortgage monies, notwithstanding the fact that the mortgaged property was sold many years ago. The decision in *Wilkinson* suggests that this argument is unlikely to succeed.

Where the lender has exercised the statutory power of sale under s 101, the mortgage monies must have "become due" before the property was sold, and in possession proceedings the principal and arrears due and unpaid will be pleaded. It is likely that this would prevent the lender from subsequently arguing that the right to receive the monies was postponed until the date of the formal demand. Alternatively, even if there was no evidence of a formal demand in correspondence prior to possession proceedings being brought, it is open to the borrower to argue that the proceedings themselves constituted a demand for payment.

In *Wilkinson*, it was argued on behalf of the borrowers that under s 20 the monies become "receivable" even before any cause of action arose. Upon default the lender may make a demand at any time in order to complete the cause of action. Whereas other provisions in the Limitation Act 1980 state that time runs "from the date on which the cause of action accrued", s 20(1) provides that time runs from the date on which "the right to receive the money accrued". The right to receive the money necessarily precedes the date upon which a demand may be made (as otherwise any demand would be invalid), and would arise when the borrower was in default of his repayment obligations.

Lord Hoffmann did not find it necessary to decide this question, although he did conclude that "the monies had certainly become receivable when the event of default occurred". Lord Scott held that it made clear commercial sense to imply a term into the mortgage deed that upon default the outstanding principal also became due and payable.

Re-accrual upon acknowledgment

The final battleground between lender and borrower in mortgage shortfall claims is the effect of an acknowledgment or payment after the proceeds of sale of the mortgaged property have been realised. It has been in the past been argued that the receipt of the proceeds of sale constitutes a part-payment for the purposes of s 29(5) of the Limitation Act 1980, although this argument is now contrary to clear authority (for a review of these arguments see (2004) 148 SJ 1273). More problematic in these cases is the apparent

acknowledgment of the debt by the borrower in correspondence with the lender, which may lead to the cause of action accruing afresh at a later date, so that the proceedings are no longer statute-barred.

For those representing defendants to mortgage shortfall claims, correspondence may be written on an expressly without-prejudice basis to avoid any argument that the debt has been acknowledged. However, before instructing solicitors to act for them, borrowers have often entered into written correspondence with the mortgagee which may amount to an implied or express acknowledgment that the debt is due.

This situation was considered by the Court of Appeal in *Rashid*. A number of letters had been written to the lender by the borrower or on his behalf, which admitted the existence of the debt and made offers to repay the debt on an instalment basis. None of these letters were marked 'without prejudice'. The building society argued that these letters constituted acknowledgments within s 29, as a result of which the cause of action accrued afresh. The Court of Appeal rejected these arguments holding that the letters were inadmissible against the defendant as privileged correspondence preparatory to settlement negotiations. Although neither of the letters relied upon were headed 'without prejudice', the operation of the rule was not dependent upon the use of that phrase.

While Sir Martin Nourse stated that the application of the privilege rule in each case was dependent upon its own facts, and that the case was "unlikely to serve as precedent for any other", this case provides a useful survey of the principles that will be applied when privilege is relied upon by a defendant to a mortgage shortfall claim. It is also clear that this judgment does not have the effect of making all acknowledgments that would otherwise fall within s 29 privileged. An acknowledgment that the debt is due would, without more, still fall foul of s 29, as would an acknowledgment accompanied with a refusal to pay.

Conclusion

The judgment in *Wilkinson* has resolved any lingering uncertainty as to the application of s 20 to mortgage shortfall claims. It has also provided guidance as to the likely approach that will be taken where the terms of the mortgage provide that the principal will become repayable 'upon demand' and the mortgagee has postponed the making of the demand until a later date in order to extend the limitation period. In these cases, it is likely that the monies will be deemed to have become receivable upon default.

The decision of the Court of Appeal in *Rashid* suggests that correspondence written in an effort to reach agreement as to the repayment of the mortgage debt will be privileged and therefore inadmissible.

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