
The Rule in Dearle v. Hall and Equitable Mortgages by Deposit of Title Deeds
Author(s): Mika Oldham
Source: *The Cambridge Law Journal*, Vol. 54, No. 2 (Jul., 1995), pp. 249-253
Published by: Cambridge University Press on behalf of Editorial Committee of the Cambridge Law Journal

THE RULE IN *DEARLE* V. *HALL* AND EQUITABLE MORTGAGES BY DEPOSIT OF TITLE DEEDS

IN *United Bank of Kuwait p.l.c.* v. *Sahib* [1995] 2 WLR 94, the plaintiff, United Bank of Kuwait p.l.c., obtained judgment against the first defendant, Mr. Sahib, in the sum of £229,815·17, being principal and interest due in respect of banking facilities granted to him. In October 1992 the plaintiff obtained a charging order nisi, made absolute in November 1992, for the purpose of securing and enforcing that judgment debt against, inter alia, Mr. Sahib's interest in a freehold property in Hampstead, London. The present proceedings had been brought for the purpose of enforcing the charging order, but neither Mr. Sahib nor the second defendant, his wife, joint owner of the property, took any substantial part. The real dispute was between the plaintiff and the third defendant, Société Générale Alsacienne de Banque S.A. ("Sogenal"), which claimed an equitable mortgage over Mr. Sahib's interest in the property. In a reserved judgment, Chadwick J. found in favour of the plaintiff and issued a declaration that the defendant bank, Sogenal, held no equitable mortgage or charge over Mr. Sahib's undivided share in the proceeds of sale of the property.

Sogenal's claim to an equitable mortgage was based on an advance of £130,000 made to Mr. Sahib in September 1990. That advance became the basis of a series of successively renewed time deposits by Sogenal with Mr. Sahib. There was evidence that by August 1992 it was accepted between Sogenal and Mr. Sahib that the current time deposit was secured by reason of Mr. Sahib's holding the land certificate for the property to Sogenal's order.

1. The rule in Dearle v. *Hall*

It was accepted in argument that since only one of the two joint owners of the property had authorised the land certificate to be held to the order of Sogenal, the only interest that Sogenal could have—and indeed the only interest which the plaintiff bank could have under its charging order—was a mortgage or charge over Mr. Sahib's equitable interest under the trust for sale upon which the property was held. That interest was an undivided share, since the creation of a mortgage or charge effected a severance of the equitable estate. The first question was whether, if Sogenal did have an interest as equitable mortgagee or chargee, priority as between the plaintiff bank and Sogenal would be governed by the much criticised rule in *Dearle* v. *Hall* (1828) 3 Russ. 1. Where the rule applies priority depends upon the order in which notice of the mortgage is received by the trustees for sale (Law of Property Act 1925, s. 137(2)(ii)). Where, as here, the mortgagor is one of two trustees, notice is not effective unless given to the other trustee: *Lloyds Bank Ltd.* v. *Pearson* [1901] 1 Ch. 865. Mrs. Sahib, the second trustee, had been present at the hearing when the plaintiff's charging order was made absolute and therefore had notice of the plaintiff's charge, but did not have notice of Sogenal's charge until some time after the commencement of the present proceedings. Therefore, if the rule in *Dearle* v. *Hall* applied, the plaintiff would have priority over Sogenal.

Following *Scott* v. *Lord Hastings* (1855) 4 Kay & J. 633, however, the court held that the rule in *Dearle* v. *Hall* does not apply where a judgment creditor, who had been content to extend credit without security, had subsequently obtained a charging order against the debtor. Two reasons were given: first, the rationale of the rule is that by failing to give notice to the trustees (of whom enquiry might be made), the assignee puts the assignor in a position to make a fresh assignment to a third person who, in reliance on the fraudulent representations as to title of the assignor, decides to give credit against the security offered. A judgment creditor was merely concerned to obtain whatever security he could in respect of credit already given to the debtor and was not at all in the same position as one who was deciding whether to give credit against the security which he was offered. Second, a debtor received no consideration from the judgment creditor at the time that the charge was created; as chargee, the judgment creditor was a volunteer and the rule in *Dearle* v. *Hall* did not assist a volunteer, who could therefore take no more than the assignor or chargor was able to give.

The ruling is welcome, given the impracticability of the rule in *Dearle* v. *Hall* in the context of commercial transactions such as non-notification factoring and block discounting. Until such time that a

system of registration of debts is introduced to cover all assignments of intangibles—thereby effectively rendering the rule obsolete—any restriction on its scope of application is to be applauded.

2. Equitable mortgages by deposit of title deeds

Given the inapplicability of the rule in *Dearle* v. *Hall*, the court had to consider the validity of the equitable mortgage asserted by Sogenal. The court held, first, that subject to any other defect, since both Sogenal and Mr. Sahib intended the security to extend to the whole legal and beneficial interest in the property, the agreement to charge the whole would, following *Thames Guaranty Ltd.* v. *Campbell* [1985] Q.B. 210, be treated as effective to create an equitable charge over Mr. Sahib's beneficial interest alone.

As regards the mortgage by deposit, since *Russel* v. *Russel* (1783) 1 Bro. C.C. 269 it has been accepted doctrine that an equitable mortgage may be created by the deposit of title deeds with the intention of creating a security. In *Sahib* Chadwick J. held that the coming into force of section 2(1) of the Law Property (Miscellaneous Provisions) Act 1989 has precluded the creation of such mortgages by deposit.

The decision clarifies what had been a matter of some debate. Section 2(1) of the 1989 Act requires that a contract for the sale or other disposition of an interest in land be made in signed writing and contain all the agreed terms. The traditional rationale of the doctrine in *Russel* is that deposit of title deeds with the relevant intention constitutes part performance of an agreement to mortgage, but this rationale does not explain satisfactorily why no writing is required. The difficulty is that a mortgage by deposit creates a security enforceable by the mortgagee, whereas the doctrine of part performance requires the person seeking to enforce the agreement to rely on his own part performance, not that of the other party. For this reason it has been argued that mortgages by deposit comprise a *sui generis* category of equitable mortgage or charge rather than agreements to create a charge, and that as such they are not caught by section 2. An alternative argument is that mortgages by deposit survive the enactment of section 2 because they are expressly recognised in the 1925 legislation. This last argument was not considered by Chadwick J. in *Sahib*, who held that whichever of the first two analyses was correct, a mortgage by deposit is contract-based and therefore falls within the ambit of section 2.

3. Law of Property Act 1925, s. 53

In case he was wrong in his finding that equitable mortgages by deposit are no longer capable of creation, Chadwick J. gave two further reasons for his decision in favour of the plaintiff. The first is

uncontroversial: that a deposit of title deeds by one joint tenant without the consent of the other is not an effective deposit because it does not give the depositee the right to retain custody until the debt is paid. His second reason is perhaps less compelling: that section 53(1)(*c*) of the Law of Property Act 1925, which requires a disposition of a subsisting equitable interest to be in signed writing, would render the transaction void. The question—analogous to the "subtrust" issue that has vexed generations of students grappling with formalities of trusts—is whether the creation of a mortgage or charge over a subsisting equitable interest constitutes a "disposition" or whether it comprises instead the creation of an entirely new interest in land. If, as in the present context seems more likely, the latter is the true construction, the problem would seem to lie rather in the provisions of section 53(1)(*a*), which requires signed writing for the creation or disposition of any interest in land. In either event, in light of the long acceptance of the doctrine of mortgages by deposit, it must surely be too late to raise such objections, or every mortgage by deposit created since 1926 would be invalidated. This was the view adopted by the Supreme Court of Victoria in *Francis* v. *Francis* [1952] V.L.R. 321.

Finally, Chadwick J. considered the possibility of bringing the mortgage by deposit within the saving provision of section 53(2) of the Law of Property Act 1925, which preserves from the force of section 53(1)(*a*)–(*c*) resulting, implied or constructive trusts. He concluded that

> If an implied or constructive trust is to arise by operation of law it must do so because the debtor/depositor has become subject to an obligation which equity will enforce. A debtor who has agreed that his property shall stand as security for a debt may, perhaps, be said to hold that property upon constructive trust to give effect to his agreement. . . . But that is because the charge is contract based. It is, in my view, impossible to rely upon section 53(2) of the Act of 1925 in this context without accepting that the charge arises by virtue of an agreement. Acceptance of that would lead [counsel for the third defendant] back into the difficulties posed by section 2 of the Act of 1989 which he seeks to avoid by relying on the deposit of the land certificate.

There is, with respect, a serious flaw in this part of the judgment, in that section 2(5) of the Law of Property (Miscellaneous Provisions) Act 1989 expressly provides that nothing in the section affects the creation or operation of resulting, implied or constructive trusts.

The courts have already shown themselves willing to circumvent the effects of section 2 by the use of collateral contracts (see *Pitt* v. *P.H.H. Asset Management* [1994] 1 W.L.R. 327) and a strained analysis of the concept of an option (*Spiro* v. *Glencrown Properties Ltd.* [1991] Ch. 537). It seems that in appropriate circumstances it

would still be open to a litigant who seeks to enforce an equitable mortgage by deposit to argue that the owner holds on constructive trust to give effect to the agreement and that the transaction therefore falls outside the ambit of both section 53(1) of the 1925 Act and section 2(1) of the 1989 Act.

MIKA OLDHAM