

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 03/11/2011

Before :

MR JUSTICE ROTH

Between :

FENLAND DISTRICT COUNCIL

Appellant

- and -

(1) ERIC WILLIAM SHEPPARD
(Trustee in Bankruptcy of Chris Constantine)

Respondents

(2) RICARDO ETTORE PARISI

(3) CAROLE FRANCIS PARISI

Becket Bedford (instructed by **Rory McKenna, Solicitor, Fenland District Council**) for the
Appellant

Philip Flower (instructed by **Simon Rodkin Litigation Solicitors**) for the **Respondents**

Hearing dates: 11 October 2011

Judgment

Mr Justice Roth :

1. This case raises a short but somewhat difficult point under the provisions governing the vesting of disclaimed property of a bankrupt's estate under section 320 of the Insolvency Act 1986 ("the Act"). It arises on an appeal against the order of Deputy District Judge Aitkin made in the Central London County Court on 12 April 2011. It would appear that directions must have been given for the application for permission to appeal against that order to be heard orally followed by the substantive appeal hearing if permission is given, although no copy of such a direction was produced to the court. In any event, this case has been heard on that assumption and I should make clear at the outset that I do give permission to appeal.
2. The facts are relatively simple. The case concerns a property at 24 High Street, Wisbech, Cambridgeshire ("the Property"), which is a derelict former shop-site close to the centre of town. The freehold of the property had been owned by Mr Chris Constantine, who was adjudicated bankrupt on 9 June 2008 ("the Bankrupt"). The Property is in very poor condition and in 2008, around the time of the bankruptcy, the appellant as the local authority carried out building work to make the Property safe pursuant to section 78 of the Building Act 1984. The appellant's cost of that work was close to £72,000 and in consequence the appellant has an interest in the form of a charge over the Property under section 107 of the 1984 Act. That charge is a local

land charge within the meaning of section 1(1)(a) of the Local Land Charges Act 1975 and was duly registered on 21 November 2008.

3. By notice dated 19 May 2010 and served on 25 May 2010, the first respondent, as trustee in bankruptcy of Mr Constantine, served a notice under section 315 of the Act disclaiming the Property.
4. The second and third respondents, who are husband and wife, are mortgagees of the Property under a mortgage that was registered on 4 March 2004. In fact, the second and third respondents (or possibly only the second respondent) used to be the freehold owner of the Property before it was acquired by the Bankrupt. It appears that the sale price to the Bankrupt was £77,000 and that this sum was not actually paid but secured by way of a mortgage over the Property in that amount plus interest. However, there is no suggestion that either the transfer to the Bankrupt or the mortgage is in any way a sham.
5. It is common ground that the appellant's statutory charge, although later in time than the registered mortgage, ranks in priority to it.
6. Section 315(3) of the Act provides:

“A disclaimer under this section-

- (a) operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the bankrupt and his estate in or in respect of the property disclaimed, and
- (b) discharges the trustee from all personal liability in respect of that property as from the commencement of his trusteeship,

but does not, except so far as is necessary for the purpose of releasing the bankrupt, the bankrupt's estate and the trustee from any liability, affect the rights or liabilities of any other person.”

It would appear, therefore, that upon the first respondent's disclaimer, the Property invested in the Crown, either by way of escheat or as bona vacantia. It may be that technically the Crown Estate Commissioners should have been made respondents to the application for a vesting order, but no point was taken on that in the court below and, given the values involved, it seems clear that they would have no real interest in these proceedings. The Bankrupt's trustee has been joined, as I mentioned above, but has taken no part in the proceedings.

7. The present position is that nothing is happening to the Property, which is described by the appellant as an eyesore in the centre of the town. In support of its application, the appellant has produced a valuation by a surveyor at the Valuation Office Agency, estimating that in its current state of repair the Property has a market value of a nominal sum not exceeding £10,000. By contrast the second respondent, who is engaged in commercial property development, expresses the view that the value of the site is much higher and he exhibits a letter dated 25 November 2008 from local estate

agents which stated that it “would have a reasonably good chance of selling by auction” and recommended an asking price of £35,000-40,000. But he says that much greater value would be realised in the event that a development grant was given for the site, in which case he estimates that the site would be worth at least £100,000.

8. It is against that background that the appellant applied for a vesting order on terms that the second and third respondent be excluded from any interest in or over the Property and that their registered charge be deleted.
9. The application was made under section 320 of the Act which provides, insofar as material:

“320(1) This section and the next apply where the trustee has disclaimed property under section 315.

320(2) An application may be made to the court under this section by-

(a) any person who claims an interest in the disclaimed property,

(b) any person who is under any liability in respect of the disclaimed property, not being a liability discharged by the disclaimer, or

...

320(3) Subject as follows in this section and the next, the court may, on an application under this section, make an order on such terms as it thinks fit for the vesting of the disclaimed property in, or for its delivery to-

(a) a person entitled to it or a trustee for such a person,

(b) a person subject to such a liability as is mentioned in subsection (2)(b) or a trustee for such a person, or

...

320(4) The court shall not make an order by virtue of subsection (3)(b) except where it appears to the court that it would be just to do so for the purpose of compensating the person subject to the liability of the disclaimer.”

10. The learned Deputy District Judge, by her judgment, held that the appellant should be granted a vesting order of the freehold under section 320 but that this should not be on terms that it extinguish the second and third respondents’ rights. She distinguished the case of *Hackney LBC v Crown Estate Commissioners* [1996] BPIR 428, on which the appellant strongly relied, and held that such terms would be a draconian measure and that there was no evidence before the court that would justify it. She therefore stated that she would make a vesting order on terms that do not extinguish the rights of the second and third respondents.

11. However, with all respect to the learned Deputy District Judge, she had clearly misunderstood the basis of the appellant's application since it was not seeking a vesting order without such terms attached. I am told this was made clear to the judge in submissions following the delivery of her judgment and that explains why the order which she then made was not in terms of her judgment but simply dismissed the application. It is against that order that the appellant appeals and it is made clear to me that it only wants a vesting order which provides for exclusion of the second and third respondents' interests.
12. Mr Bedford, appearing here as he did below on behalf of the appellant, explained that the reason for this was that if such terms are not incorporated and the charge by way of mortgage remains, then upon the appellant becoming the freehold owner, its charge securing its claim for some £72,000 would be extinguished and the second and third respondents would take the benefit of any value in the Property. As it is put in the grounds of appeal, and repeated in Mr Bedford's skeleton argument, it is the appellant's case that the judge's view that the property should vest in the appellant on terms which preserve the second and third respondents' charge "effectively reverse[es] the admitted priority of the appellant's local land charge over that of the second and third respondents". This argument is nowhere considered in the reasoning of the court below and the fact that by the judgment (although not in the final order) the judge held that an unrestricted vesting order should be made and did not address the potential implications for the appellant's right of recovery of the costs of its work means that she failed to take into account a material consideration. The terms of the vesting order are a matter for the discretion of the court under section 320(3), but in my judgment this omission impugns the exercise of discretion by the judge. Although this is an appeal under section 375(2) of the Act, it is accordingly for this court to consider the matter afresh.
13. Before addressing the contention regarding the defeat of the appellant's prior charge to which I have just referred, it is appropriate to consider the submission that the *Hackney* case is authority for making an order in the terms sought and was wrongly distinguished by the judge. In *Hackney*, a notice of disclaimer of the freehold in a derelict building was similarly given by the trustee of the bankrupt freehold owner. There, too, the local authority had charges registered against the property in respect of the cost of works carried out to maintain a dangerous structure. And there, too, there was a mortgage of the property by way of a charge registered previously, in that case in favour of the National Westminster Bank plc ("the Bank"). Knox J made a vesting order in favour of the borough council on terms setting aside the Bank's charge
14. However, the relevant figures in that case were that the borough council's charge was in respect of a claim to a little under £15,000; the Bank's charge was for over £133,000; and the value of the premises was undisputed at £10,000. In those circumstances, it was unsurprising that the Bank did not oppose the borough council's application for a vesting order on terms that set aside the Bank's charge. The Crown Estates Commissioners were also made respondents to the application and similarly raised no objection. In his reasoning, Knox J stated:

"In the light of the totally impassive attitude adopted by the two respondents and the unchallenged evidence as to the value of the property I do think it fit to make a vesting order in favour of the London Borough of Hackney, freed and discharged from all

estates and interests of the Crown Estate Commissioners and the NatWest Bank.”

15. Moreover, the contested issue before the court in *Hackney* was whether the borough council was a person holding an “interest” in the disclaimed property falling within section 320(3)(a). The registrar had held that it was not, and on appeal Knox J held that this was wrong. That was what *Hackney* determined, and in the present case there is no dispute that the appellant is a person entitled to an interest in the Property for the purpose of this provision.
16. Accordingly, I respectfully agree with the judge below that the *Hackney* case is clearly distinguishable, although in what was no doubt a slip she referred to it being a case concerning section 320(3)(b) instead of 320(3)(a).
17. Mr Bedford points to the concluding paragraph of Knox J’s judgment, where he stated:

“Finally, I should say that had the NatWest Bank taken anything other than a supine attitude in this matter I would have been minded to afford it an opportunity of applying for and taking a vesting order in its favour subject to the local land charges registered in favour of the London Borough of Hackney. Since on the figures this would have involved the NatWest Bank acquiring an asset worth £10,000 with liabilities worth a minimum of £14,781, it seemed to me clear that it would not have wanted to avail itself of such an option.”

However, not only is that observation *obiter* but it provides no authority for concluding that *unless* the Bank applied for a vesting order the Court was bound to set aside the Bank’s charge when making such an order in favour of the borough council.

18. I turn therefore to the appellant’s argument that unless the mortgage is set aside, a vesting order in its favour will here effectively benefit only the mortgagees since it will deprive the appellant of its prior claim to some £72,000. The second and third respondents, no doubt for their own reasons, did not dispute that proposition and instead countered that to discharge their interest would be a violation of their right to property under Article 1 of the 1st Protocol to the European Convention on Human Rights (“ECHR”). Accordingly, Mr Flower on their behalf submitted that the court should interpret the broad discretion under section 320(3) as not permitting such an extinguishing of their property rights.
19. However, I consider that the fundamental premise underlying the appellant’s submission is misplaced. In equity, the test for whether or not a merger occurs looks to the intention of the parties and, if there is no such evidence of intention, to the benefit that will accrue to the party in which the charge and freehold interest would potentially unite.
20. In the recent judgment of Rimer LJ in the Court of Appeal in *BOH Ltd and ors v Eastern Power Networks plc* [2011] EWCA Civ 19, [2011] 1 P&CR DG 26, the relevant authorities are conveniently summarised and quoted. *Ingle v Vaughan Jenkins* [1900] 2 Ch 368 was a case concerning the question of merger of an equitable

lease in the legal estate of the freehold, but Farwell J made clear that the applicable principles were the same for a lease as for charges. He described those principles as follows (at 370-371):

“Whatever might have been the case at common law, as to which it is unnecessary that I should express an opinion, it is, in my opinion, clear that [the lease] was not merged or extinguished in equity. I think the proposition in Lewin on Trusts, 10th ed. p. 889, is correct—namely, that “The principle by which the Court is guided is the *intention*; and in the absence of express intention, either in the instrument or by parol, the Court looks to *the benefit of the person in whom the two estates become vested*.” The author goes on to point out that the chief importance of the doctrine of merger is with reference to charges, and the cases he cites are confined to charges.

The defendant contended that a different principle applied in the case of a lease, but I am unable to follow that distinction. The principle being that the Court looks to the benefit of the person in whom the interests coalesce, I cannot see why there should be any distinction in this respect between a beneficial lease and a term to secure a charge. In either case the term is taken as an equivalent for money expended. Nor do I think it makes any difference whether the coalescence of the interests is brought about by operation of law or the acts of the parties. The principle of *Grice v. Shaw* 10 Hare 76, is applicable to the present case. The head-note is as follows: ‘Where the tenant in fee or in tail of an estate becomes entitled to a charge upon the same estate, the general rule is, that the charge merges, unless it be kept alive by the party entitled to it; and where the merger of the charge would have let in other charges in priority, thereby rendering it the interest of the owner of the estate to keep alive his charge, the Court presumed that such was his intention, notwithstanding the absence of any other indication of such intention.’” [Emphasis in the original]

21. As Rimer LJ states, in the *Grice* case there was no evidence of any express intention to keep the charge alive and the question was what intention should be *presumed* with regard to it. Since it was in the chargee’s interest to keep his charge alive, that intention was presumed by the court.
22. The principle was applied by the Court of Appeal in *Capital and Counties Bank Ltd v Rhodes* [1903] 1 Ch 631. There, Cozens-Hardy LJ (with whose judgment Romer LJ agreed) stated (at 652) that the equity courts:

“had regard to the intention of the parties and, in the absence of any direct evidence of intention, they presumed that merger was not intended, if it was to the interest of the party, or only consistent with the duty of the party that merger should not take place.”

23. On the basis of those authorities, Rimer LJ summarised the test for determining whether or not a merger had occurred as follows, at [40]:

“The starting point is that whereas the ordinary rule at law was that the coalescence of a lease and its reversion in the same person (‘A’) in the same right would result in a merger and extinguishment of the lease, in equity, it was open to A to form an intention, and declare accordingly, that there should be no such merger and extinguishment. Equity further developed the principle that in any case in which A did *not* expressly evince such an intention, or in which there was no other evidence of such an intention on his part, there was a presumption against any intention for a merger if such would be against his interest. In a case in which there was no express declaration or other evidence as to A’s intentions, the focus of equity’s inquiry was therefore exclusively on his interests: and if a merger would be against his interests, he is presumed to have intended against any merger. That is the principle that was applied in *Ingle* and this court in *Rhodes* made it clear that it regarded *Ingle* as having been correctly decided.”

24. In the present case, it seems to me that the appellant would clearly be presumed to intend to preserve the benefit of its charge if the freehold was vested in it by order of the court, since that is manifestly in its interest. Accordingly, a vesting order would not have the effect on which Mr Bedford’s submission was premised. Moreover, the court could expressly provide that the charge should be preserved as a term of the vesting order under section 320(3) of the Act.
25. Although neither side cited these authorities in argument, when I put it to Mr Bedford that some term might be imposed as part of the vesting order that served to preserve the appellant’s priority for its claim to £72,000 over the second and third respondents’ mortgage, his response was that this was not satisfactory. This was explained on the basis that the appellant might wish to expend significant sums redeveloping the property which might then be sold for more than £72,000. In those circumstances, it was submitted, it was unfair that the second and third respondents should be able to recover under their mortgage for the balance over £72,000 leaving the appellant potentially unable to recoup its additional expenditure.
26. The difficulty about that submission is that it is purely speculative. There is no suggestion in the detailed witness statement of the chief solicitor to the appellant that there is a realistic prospect of the Property being worth more than £72,000, or of any likely further costs that the appellant expects to expend. I have already referred to the specific evidence that he exhibits as to the current value of the Property, and his witness statement concludes by stating that the appellant has “no option” but to seek a vesting order free of the second and third respondents’ charge “in order to have any prospect of either recovering its expenditure or of developing the [Property] in conjunction with other persons who may be able to offer the applicant better value for money.” Accordingly, that evidence proceeds on a mistaken assumption regarding the effect of a vesting order on the appellant’s charge. It would in my judgment be quite wrong for the court to go further and deprive the second and third respondents

of their interest, against their opposition, on the basis of a purely hypothetical suggestion as to what other development might take place.

27. That is accordingly sufficient to dispose of the other main ground advanced by the appellant on this appeal. It is therefore unnecessary to consider the second and third respondents' human rights argument, which was not raised in the court below or the subject of a respondent's notice but first put forward in counsel's skeleton argument.
28. There are few authorities concerning the disclaimer provisions on personal bankruptcy in sections 315-321 of the Act, but there are rather more concerning the parallel provisions that apply on corporate insolvency in sections 178-182. In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70, Lord Nicholls of Birkenhead gave the leading speech (with which the other members of the House of Lords agreed) and referred to these provisions as follows (at 86-87):

“The fundamental purpose of these provisions is not in doubt. It is to facilitate the winding up of the insolvent's affairs. There is a further purpose in personal insolvency cases. A bankrupt's property vests automatically in his trustee. The disclaimer provisions operate to discharge the trustee in bankruptcy from all personal liability in respect of the Property: see section 315(3)(b).

Equally clear is the essential scheme by which the statute seeks to achieve these purposes. Unprofitable contracts can be ended, and property burdened with onerous obligations disowned. The company is to be freed from all liabilities in respect of the property. Conversely, and hardly surprisingly, the company is no longer to have any rights in respect of the property. The company could not fairly keep the property and yet be freed from its liabilities.

Disclaimer will, inevitably, have an adverse impact on others: those with whom the contracts were made, and those who have rights and liabilities in respect of the property. The rights and obligations of these other persons are to be affected as little as possible. They are to be affected only to the extent necessary to achieve the primary object: the release of the company from all liability.”

Although those observations refer to the sections concerning disclaimer and not the following provisions concerning a vesting order, it seems to me that this should similarly characterise the approach to a vesting order. So far as possible, the interests of third parties should be preserved.

29. It follows that I would have been prepared to make a vesting order in favour of the appellant but, like the judge below, without discharging the interest of the second and third respondents. Since the appellant has not asked for such an order, on the basis of this judgment its appeal would be dismissed. However, if on consideration of this judgment the appellant wishes to have a vesting order on terms that preserve its charge, I shall hear counsel as to whether such an order should now be made.