

THE EFFECT OF A CAVEAT ON A MORTGAGEE'S
POWER OF SALE

Report of the Property Law
and Equity Reform Committee

Presented to the Minister of Justice
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With the Compliments of
the Secretary for
Justice

Wellington,
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PROPERTY LAW AND EQUITY REFORM COMMITTEE'S
REPORT ON
THE EFFECT OF A CAVEAT ON A MORTGAGEE'S POWER OF SALE

The Minister of Justice:

Introduction

1. The committee has been asked to consider the situation of a caveat preventing the registration of a transfer pursuant to a power of sale under a prior registered mortgage.

The committee was informed of a growing practice under which mortgage documents (especially for third or subsequent mortgages) are retained unregistered by the mortgagee who instead protects his interest by lodging a caveat. Under a recent ruling of the High Court discussed below it has become clear that in the event of a mortgagor's default, the caveat may hinder the prior mortgagee in carrying out his sale of the property.

The Present Law

2. Under section 105 of the Land Transfer Act 1952, on registration of such a transfer the mortgagor's estate vests in the purchaser free from the mortgage and any estate or interest subsequent to the mortgage. However under section 141 of the Act so long as a caveat in Form N (caveat forbidding registration or dealing with estate or interest) remains in force the District Land Registrar is not to make any entry on the register having the effect of charging or transferring or otherwise affecting the estate or interest protected by the caveat. The prohibition does not apply to completing the registration of an instrument accepted for registration before the caveat was lodged.

3. The Act specifies three ways of removing a caveat:

- (i) Removal by the High Court under section 143;
- (ii) Lapse after notice under section 145; and
- (iii) Withdrawal by the caveator under section 147.

4. In 1978 the Registrar-General of Land upheld a District Land Registrar's decision not to register a transfer pursuant to a mortgagee's power of sale because of a caveat lodged after the mortgage. Section 105 of the Act was considered not to apply because, apart from the prohibition in section 141, the caveat created no estate or interest but merely protected an interest

claimed. The caveat stood on its own, removable only in the manner specified by the Act.

5. The District Land Registrar and the then Registrar-General of Land took the view that however clear the apparent rights of the parties, the Court was the appropriate forum to determine those rights, not the Registrar whose functions were ministerial or administrative.

6. In a later case on 23 September 1980, after the committee had begun its consideration of this topic, Barker J delivered his judgment in Stewart v. District Land Registrar (High Court, Auckland M699/80) upholding the District Land Registrar's refusal to register such a transfer because of a subsequently lodged caveat claiming an estate by virtue of an agreement to mortgage, and confirming that section 105 of the Act did not apply because the caveat itself was not an encumbrance or mortgage, but merely a notice of potential claim. This cannot have been intended by the original framers of the legislation and an urgent review of the present law is called for.

Preliminary View

7. Our initial view was that the caveat's effect further whittles away the prior mortgagee's paramount title, thought to be guaranteed by the Act. The mortgagee buying in or, if selling, his purchaser should not be put to the trouble and expense, and probable delay and uncertainty of a court action, whether instituted by the mortgagee under section 143 or by the caveator under section 145.

Accordingly, we circulated a working paper proposing certain amendments to the Land Transfer Act 1952 and the Property Law Act 1952 to provide for the automatic clearing of not only subsequent caveats, but also of subsequent charging orders under Rule 315 of the Code of Civil Procedure on registration of the transfer.

The Law in Other Jurisdictions

8. The committee made enquiries as to the position in other jurisdictions and replies were received from:-

Registrar of Titles, Queensland
Director of Land Titles, New South Wales
Law Institute of Victoria
Registrar-General, Department of Lands, South Australia
Acting Deputy Recorder of Titles, Tasmania
Registrar of Titles, Western Australia

Attorney-General's Office, Alberta
Registrar-General, Land Titles Office, Manitoba
Director of Land Titles, British Columbia
Master of Titles, Saskatchewan
Director, Ministry of Consumer and Commercial Relations,
Property Rights Division, Ontario.

9. From these replies it appears that the Torrens system in the different jurisdictions has become quite diversified on this matter. But the main streams appear to be as follows:

- (a) In Queensland caveats lapse within three months after lodgment unless lodged with the written consent of the registered proprietor or unless within that time proceedings are taken by the caveator to establish his title to the estate or interest claimed and he has given written notice thereof to the Registrar.

Until 1979 caveats lodged precluded the registration of instruments whether accepted for registration before or after the caveat was lodged. However under amending legislation passed in 1979 caveats protecting a claimed estate or interest in the land as security for the payment of a loan, an annuity or a sum of money (even if consented to by the registered proprietor) are cancelled on a sale by a prior registered mortgagee as if they were subsequently registered mortgages, with a discretion to the Registrar not to register to cover doubtful situations.

- (b) In South Australia the practice has been to register transfers from prior registered mortgagees, regarding those caveats, liens and writs (or warrants) subsequently entered on the register as being extinguished upon registration of a mortgagee's transfer.

In Tasmania a similar procedure operates where the Registrar is satisfied that registration of the transfer is not expressly prohibited by the caveat; while in Western Australia the transfer from the prior registered mortgagee will be registered unless the caveat is directed to the mortgage itself.

- (c) In Victoria steps are being taken to amend the statute so that all caveats lapse on registration of the transfer, other than caveats claiming under an unregistered instrument to which the selling mortgagee has consented in writing or to which he is a party or caveats claiming an interest which is for any reason specified in a caveat as binding upon that mortgagee.

- (d) In New South Wales the courts having clarified the weak position of subsequent mortgagees who rely on caveats; Kerabee Park Pty Ltd v. Daley [1978] 2 NSWLR 222, a review of the caveat provisions on a wider basis is to be undertaken, as it has been suggested that the present provisions may nevertheless give caveators more opportunity to frustrate the registration principles of the Torrens system than their claims, sometimes tenuous, warrant.

- (e) In Manitoba the statute provides expressly that the filing of a caveat gives the same effect, as to priority, to the instrument or subject matter on which the caveat is based, as the registration of an instrument under the Act. But where

the "caveator" has issued proceedings to which the mortgagee is a party or which call into question the mortgage or the right of the mortgagee to proceed and notified the Registrar, the Registrar awaits the resolution of the matter by agreement or court order.

- (f) Under a 1979 enactment in British Columbia, notice is given to the Registrar of the intended exercise of the power of sale and (apart from specific exemptions in favour of notices under the Conditional Sales Act and Mobile Homes Act) all notices of an interest right or claim lodged thereafter are of no effect as against the mortgagee.
- (g) In Ontario the caveator is served with notice of the proposed exercise of the power of sale and must establish his rights.

10. In summary it appears that:

- (a) In some jurisdictions priority is all important.
- (b) This obtains in a number of other jurisdictions, except where the selling mortgagee consents or is an involved party in respect of the caveator's claim.
- (c) To cover the exceptional cases, in some jurisdictions the Registrar makes a decision, which could be a decision on fact and law, as to whether the caveat stands or falls.
- (d) In others the caveator has the burden of establishing his claim, and must prosecute it or it falls.
- (e) In Australia, the "caveat for second mortgage" procedure which has appeared in New Zealand is being defeated by judicial decision or legislative amendment.

The Committee's Proposals

11. On further consideration the committee modified its initial view in certain respects. It also decided that in view of the different issues involved in charging orders and the pending revision of the Code of Civil Procedure, this report should deal with caveats only, leaving charging orders for later consideration.

12. The committee certainly considers that the present system can create an anomaly. The unregistered mortgagee by lodging a caveat can effectively place himself in a stronger position than if his mortgage was registered. He can impede a prior registered mortgagee's power of sale and is safe to the extent that his caveat will not lapse without notice to him. The registered mortgagee must then either apply to the court for removal of the caveat, or else proceed with his sale and have the transfer presented for registration, putting the unregistered mortgagee on notice to apply for a court order preventing the caveat from lapsing. But he is put to the additional expense and inconvenience of having to remove the caveat in one way or the

other before the transfer can be registered. This places a registered mortgagee at an unwarranted disadvantage where a caveat protects the interest of a subsequent equitable mortgagee.

13. At the same time the committee sought a solution that would not prejudice a caveat where it protects an equitable interest which takes priority over the registered mortgagee's legal title. This can arise from dealings by the caveator with either the registered proprietor or the registered mortgagee. Such caveats are not likely to be common but would include by way of example the caveat protecting a right of way under an agreement that is not registered because of survey costs and the caveat lodged by a beneficiary to prevent a trustee who, in breach of trust, has invested trust funds on mortgage from assigning or discharging that mortgage.

14. Thus the committee considers that the reform should be limited to cases where the caveat has been lodged by a person who claims under an unregistered or unregistrable instrument, that is inferior to the registered mortgagee's. In the committee's opinion the most appropriate reform would be to enable the District Land Registrar to register a transfer pursuant to a mortgagee's sale where he is not satisfied the caveat protects an interest which, if registered, would be superior to that of the registered mortgagee. This would in effect place on the caveator the onus of sustaining his caveat. However the committee envisages that in the majority of cases the caveat would automatically lapse because it would relate to an estate or interest inferior to that of the registered mortgagee.

15. The District Land Registrar's decision would in each instance be based on the particulars contained in the caveat. If a caveator has a claim affecting the interest of the mortgagee it will be important for him to state it but he is already obliged to do that. A caveator must state with sufficient certainty the extent of the estate or interest to which he claims he is entitled and failure to do so may result in the court refusing to grant an order that the caveat should not lapse: see New Zealand Mortgage Guarantee Company v. Pye [1979] 2 NZLR 188. It would therefore only be a matter of drafting for the caveator with a prior equitable right to define with sufficient precision the interest or estate the caveat is intended to protect so it does not lapse in the event of a mortgagee's sale. The District Land Registrar's decision can be the subject of appeal or review.

16. The committee therefore recommends that section 141 of the Land Transfer Act 1952 be amended to the effect that on the presentation of a transfer pursuant to a mortgagee sale a subsequently lodged caveat should lapse unless the District Land Registrar is satisfied from the particulars stated in the caveat that the caveator claims an interest which if registered, would have priority over the registered mortgage or would affect the estate or interest of the registered mortgagee.

17. During the committee's deliberations the view was expressed that the registered mortgagee's power of sale should not prevail

over the interest of a caveator under a subsequently lodged caveat where the mortgagee has consented in writing to that caveat being lodged. Caveats in this category would consist of unregistered dealings to which the mortgagee had consented such as leases and rights of way. The mortgagee would be bound inter partes by his consent and it was unlikely he would refuse to consent to the caveat or its notification on the register. However, the committee concluded that such caveats were adequately protected under the existing law. Section 101(6) of the Property Law Act 1952 and 105 of the Land Transfer Act 1952 provide that interests created by any instrument binding on the mortgagee are not extinguished on the registration of the transfer pursuant to a mortgagee's sale.

18. To allow a caveator the opportunity to protect his equitable rights where his caveat does not clearly show the interest protected is a prior interest, the committee suggests that the registered mortgagee should be required to serve on a caveator of whose name and address he is aware, a copy of the default notice issued under section 92 of the Property Law Act 1952. This would warn the caveator that the mortgagee intends to exercise his power of sale and enable him if necessary to institute court proceedings determining the priority of his interest. The committee therefore recommends that an analogous provision to subsection 92(4) (which requires a mortgagee to send a copy of the default notice to any subsequent mortgagee of whose name and address he has actual notice) be inserted in section 92 of the Property Law Act 1952.

19. The changes to the law we have proposed are procedural in character; they relate not to the relative rights of parties, but how these rights are to be enforced. It is therefore recommended that they apply to all caveats whether lodged before or after the date of the proposed legislation.

Matrimonial Property Act Notices

20. The committee considered whether its proposals should extend to notices under the Matrimonial Property Act 1976, which are deemed to have the effect of caveats by virtue of section 42(3) of that Act. The committee does not consider that they should. The existence of a matrimonial property notice makes it likely that legal proceedings will be either instituted or pending so that resolution of any outstanding issues between husband, wife and mortgagee will come about in those proceedings. It may perhaps be illogical that matrimonial property notices should not be dealt with in the same way as caveats in this respect, especially in view of section 46 of the Act which makes the mortgagee's prior rights very clear. There is, however, always a possibility of a reorganisation of the matrimonial assets so as to save the property. Under the present law there is some hindrance to mortgagees but we are of the view this consideration is outweighed by the strong social need to keep matrimonial homes and other property within the control of the courts in the event of matrimonial disputes. The attached draft bill provides accordingly.

Conclusion

21. The Committee therefore recommends:

- (a) The enactment of legislation giving effect to the Committee's proposed amendments to section 141 of the Land Transfer Act 1952, section 92 of the Property Law Act 1952 and section 42(3) of the Matrimonial Property Act 1976 along the lines of the attached draft.
- (b) That the anomaly the Committee's proposal is intended to remedy is so clear, and the inconvenience the present law causes so great, that the reform should not be considered in the context of the general review of the Land Transfer Act but proceed separately for legislative action as soon as possible.



For the Committee

Members

Professor R.J. Sutton
Miss J.M. Potter
Mr A.J. Forbes
Mr R.G.F. Barker
Mr W.B. Greig
Mr S.F. Drummond
Miss J.M. Finnigan (Secretary)

APPENDIX I

LAND TRANSFER AMENDMENT

ANALYSIS

A BILL INTITULED

An Act to amend the Land Transfer Act 1952 in respect of the position of caveats on sales by mortgagees.

BE IT ENACTED by the General Assembly of New Zealand in Parliament assembled, and by the authority of the same, as follows:

1. Short Title and commencement - (1) This Act may be cited as the Land Transfer Amendment Act 1981, and shall be read together with and deemed part of the Land Transfer Act 1952* (hereinafter referred to as the principal Act).

(2) This Act shall come into force on the 28th day after the date on which it receives the Governor-General's assent.

*Reprinted 1970, Vol. 3, p.1991

Amendment: 1972, No. 76.

2. Effect of caveat against dealings - The principal Act is hereby amended by repealing section 141, and substituting the following section:

"141. (1) Subject to the succeeding provisions of this section, so long as a caveat in Form N remains in force, the Registrar shall not make any entry on the register having the effect of charging or transferring or otherwise affecting the estate or interest protected by the caveat.

"(2) Subsection (1) of this section shall not prevent the completion of the registration of an instrument that has been accepted for registration before the receipt of the caveat.

"(3) Except in the case of a caveat lodged by the Registrar in exercise of the powers by this Act given to him in that behalf, subsection (1) of this section shall not prevent the registration of a transfer of any estate or interest in land where -

"(a) The transfer is expressed to be made in pursuance of a power of sale conferred on the transferor by virtue of a registered mortgage of that estate or interest; and

"(b) The caveat was lodged after the registration of that mortgage; and

"(c) The Registrar is not satisfied from the particulars stated in the caveat that the estate or interest claimed by the caveator would, if registered under this Act, have priority over the mortgage or would otherwise affect the estate or interest of the mortgagee under the mortgage.

2.

"(4) In any case to which subsection (3) of this section applies, the caveat shall, upon the registration of the transfer, be deemed to be discharged and the estate or interest of the mortgagor therein expressed to be transferred shall pass to and vest in the purchaser freed and discharged of the estate or interest claimed by the caveator."

3. Property Law Act 1952 amended - Section 92 of the Property Law Act 1952 is hereby amended by inserting, after subsection (4), the following subsection:

"(4A) Where in the case of land subject to the Land Transfer Act 1952, a caveat in form N in the Second Schedule to that Act has been lodged (otherwise than by the District Land Registrar) subsequent to the registration of the mortgage, the provisions of subsection (4) of this section shall apply as if the caveat were a subsequent mortgage."

4. Matrimonial Property Act 1976 amended - Section 42(3) of the Matrimonial Property Act 1976 is hereby amended by omitting the words "shall apply accordingly except that -", and substituting the words ", except subsections (3) and (4) of section 141, shall apply subject to the following modifications:".

APPENDIX II

Submission were received from:

Eastern and Central Savings Bank
The Life Offices' Association of New Zealand Inc.
The National Bank
Bank of New Zealand
Housing Corporation of New Zealand