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Mortgage Priorities

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1. Enforcement of Mortgages *19 June 2003*
2. Indefeasibility of Mortgage Title *17 Nov 2003*
3. Mortgage Drafting in NSW *17 Mar 2004*
4. Mortgage Priorities *15 June 2004*
5. The Rights of Mortgagors *10 Oct 2005*
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Where a property is charged with debts to two or more parties it is often necessary to determine the order in which the law says the debts will be satisfied. This order, or ranking, is what the law of priorities is concerned with.

The issue of competing priorities is only relevant when the property secures debts which exceed the value of the property. Thus the different claims are known as competing priorities.

B. Priorities under the Real Property Act

The priorities between different interests, including mortgages, under Real Property Act land are governed by a combination of statutory principles (mainly contained in the Real Property Act itself, but also in the Conveyancing Act), and general law principles. These general law principles are based upon certain key maxims, the manner of operation of those maxims then having been extensively defined.

The starting point in any priority question arising with respect to Real Property Act land is the Real Property Act itself, which established a system that was described by Barwick CJ in *Breskvar v Wall* (1971) 126 CLR 376 at 381 as "title by registration" (as distinct from Old System Title under which titles could be registered but registration in and of itself did not confer title).

1. Ranking between registered dealings

S 36(9) of the Act provides:

> Dealings registered with respect to, or affecting the same estate or interest shall, notwithstanding any notice (whether express, implied or constructive), be entitled in priority the one over the other according to the order of registration thereof and not according to the dates of the dealings.

2. Indefeasibility

S 42 of the Real Property Act is the so-called "indefeasibility of title" provision in the Act, although the word "indefeasibility" does not actually appear in s 42, or indeed in any part of the Act. The section is entitled "Estate of registered proprietor paramount", and proceeds as follows:

> 42 (1) Notwithstanding the existence in any other person of any estate or interest which but for this Act might be held to be paramount or to have priority, the registered proprietor for the time being of any estate or interest in land recorded in a folio of the Register shall, except in case of fraud, hold the same, subject to such other estates and interests and such entries, if any, as are recorded in that folio, but absolutely free from all other estates and interests that are not so recorded except:

S 43(1) then states:

> Except in the case of fraud no person contracting or dealing with or taking or proposing to take a transfer from the registered proprietor of any registered estate or interest shall be required or in any manner concerned to inquire or

> ascertain the circumstances in or the consideration for which such registered owner or any previous registered owner of the estate or interest in question is or was registered, or to see to the application of the purchase money or any part thereof, or shall be affected by notice direct or constructive of any trust or unregistered interest, any rule of law or equity to the contrary notwithstanding; and the knowledge that any such trust or unregistered interest is in existence shall not in itself be imputed as fraud.

There are circumstances where the indefeasibility provisions of s 42 (mirrored also in s 43) can be overridden, in particular where a person has acquired a registered interest by fraud, or where personal rights arising under statute or at general law permit a person to defeat in practice the theoretically "indefeasible" rights of the proprietor of a registered interest. These so-called exceptions to indefeasibility, however, are a major topic in themselves and have been dealt with at length in a previous seminar paper called "Indefeasibility of Title" given by the author on 17 November 2003.

3. Legal interest under Real Property Act land

Assuming there are no circumstances which permit the defeat in a given case of the titles of the registered interest holders, then pursuant to s 36(9) of the Real Property Act, the order of registration determines the relative priority of all registered interests. Under the Real Property Act, all registered interests are thereby constituted as legal interests, and no unregistered legal interests are recognised, for s 41(1) of the Act states:

> No dealing, until registered in the manner provided by this Act, shall be effectual to pass any estate or interest in any land under the provisions of this Act, or to render such land liable as security for the payment of money, but upon the registration of any dealing in the manner provided by this Act, the estate or interest specified in such dealing shall pass, or as the case may be the land shall become liable as security in manner and subject to the covenants, conditions, and contingencies set forth and specified in such dealing, or by this Act declared to be implied in instruments of a like nature.

4. Legal interests prevail

Thus, absent any relevant exceptions to indefeasibility in a given case, the priorities as between legal interests in Real Property Act land are almost always completely determined by the order of registration of those interests. What is more, except for the very limited exceptions provided in s 42 (which include short term leases) any indefeasible registered interest will override any unregistered (or equitable) interest, regardless of such matters as the relative dates of the creation of those interests and regardless of any consideration of notice of one interest holder at the time of registration of the other competing interest (see s 43(1) previously cited). That is the principal reason why a holder of an unregistered interest is likely to lodge a caveat because the caveat prevents the registration of another interest, the registration of which interest would cause the unregistered interest to lose priority notwithstanding it arising first in time. This over-riding of equitable interest by legal interests is also consistent with the old maxim "when the equities are equal, the law prevails".

It follows that, except for the operation of certain special doctrines such as tacking, and except in a very limited category of cases in which a legal interest in Real

Property Act land can arise without registration (which will be dealt with below), the only priority questions in relation to interests in Real Property Act land that cannot be resolved by the application of indefeasibility of title (or the exceptions thereto) concern the competition for priority between unregistered interests, being equitable interests, as their priority is not regulated by the Real Property Act but are recognised under the general law principles of equity.

C. Unregistered Legal Interests

1. Priority principles relating to unregistered legal interests

There is limited scope under the Real Property Act for the existence of unregistered legal interests. It is therefore necessary to examine the rules determining priorities between competing unregistered legal interests, and between unregistered legal interests and equitable interests. It is important to stress that the expression "unregistered legal interest" is refers only to the very limited classes of interest that the Real Property Act considers as being legal interests notwithstanding lack of registration (described below); in the usual case of an unregistered interest in Real Property Act land, the interest can only be equitable.

2. Priority between unregistered legal interests

No true priority contest can arise between unregistered legal interests by reason of the famous maxim *nemo dat qoud non habet*, which may be translated as "you can't give what you don't have". As soon as a proprietor of land has conveyed a legal estate in that land to another, the proprietor cannot subsequently convey that legal estate (or an interest inconsistent with that estate) to another person, as the legal estate no longer belongs to the original proprietor, and is thus not the proprietor's to give. In the circumstances, any purported attempt of a person to convey to a second person a legal estate that has actually vested previously in a third person must be ineffective to convey a legal estate, although if the subsequent transaction is for value it may be effective to convey an equitable estate. Thus any competition between two alleged legal interests is decided in accordance with the order in time that the interests were created, with the first in time having priority and the second in time not being a legal estate at all (at least to the extent it conflicts with the prior grant).

3. Priority between unregistered legal interests and equitable interests

As between an unregistered legal interest and an equitable interest, the maxim "where the equities are equal the law prevails" is the key. The maxim provides that a legal interest generally has priority over an equitable interest. This rule has its exceptions, however, some of which are set out in *Northern Counties of England Fire Insurance Company v Whipp* (1884) 26 Ch D 482. That case dealt with the conflict between a prior legal interest and a subsequent equitable interest. At p 494 the following conclusion is reached:

> The authorities which we have reviewed appear to us to justify the following conclusions:-
>
> (1) That the Court will postpone the prior legal estate to a subsequent equitable estate: (a) where the owner of the legal estate has assisted in or connived at the fraud which has led to the creation of a subsequent equitable estate, without notice of the prior legal estate; of which assistance or

> connivance, the omission to use ordinary care in inquiry after or keeping title deeds may be, and in some cases has been, held to be sufficient evidence, where such conduct cannot otherwise be explained; (b), where the owner of the legal estate has constituted the mortgagor his agent with authority to raise money, and the estate thus created has by the fraud or misconduct of the agent been represented as being the first estate.
>
> But (2) that the Court will not postpone the prior legal estate to the subsequent equitable estate on the ground of any mere carelessness or want of prudence on the part of the legal owner.

A holder of a subsequent legal interest will rank in priority ahead of an earlier in time equitable interest, but only if the legal interest was obtained for value, in good faith, and without notice of the equitable interest: *Pilcher v Rawlins* (1872) LR 7 Ch App 259.

4. Short term leases

By reason of s 53(1) of the Real Property Act, short term leases of 3 years duration or less are in the almost unique position of not requiring an executed written lease to be valid at law. As only dealings can be registered, and with no written lease there is no dealing to register, there is no requirement of registration with respect to a short term lease, and such a lease can therefore be an enforceable legal interest without registration. Although a short term lease that is in writing and in registrable form may be registered and thereby attract the protection of indefeasibility, if a short term lease is not registered it nonetheless has effect as a legal interest.

There are special statutory rules under the Real Property Act in relation to the priorities of short term (and, to a lesser extent, long term) leases. S 42 (1)(d) of the Real Property Act provides for a limited exception to indefeasibility of title in the case of leases which have a term not exceeding 3 years (the term of any options to extend the lease being added to the original term for the purpose of this determination of the length of term). The effect of s 42(1)(d) is that if a registered proprietor had notice of an unregistered short term lease before registration, then the registered proprietor does not obtain indefeasibility over that lease by registration.

5. Easements and profits a prendre

In some circumstances easements present a limited exception to indefeasibility by virtue of s 42(1)(a1) of the Real Property Act. The exception extends only to omitted or misdescribed easements either dating from before the bringing of the land under the Real Property Act or since created under an Act. There is a more widely worded exception relating to profits a prendre in s 42(1)(b). A profit a prendre is an interest similar to an easement, but whereas an easement confers a right (normally upon a neighbour or a statutory body) to use the land (as a right of way, for example), a profit a prendre confers the right to take something from the land (such as to cut and remove wood). It should be noted that covenants over land are not an exception to indefeasibility.

An easement or profit a prendre created at a time prior to land being brought under the Real Property Act is a legal or equitable interest depending upon the rules of Old System Title, an easement or profit a prendre conferred by a deed thus being a legal

interest. An Old System Title legal easement or profit will thus have priority over a subsequent a registered mortgage (being a legal interest first in time), whilst an equitable easement or profit will only enjoy priority over a registered mortgage if the mortgagee had notice of the easement or did not give value for the mortgage.

6. S 43A of the Real Property Act

S 43A(1) of the Real Property Act provides as follows:

> For the purpose only of protection against notice, the estate or interest in land under the provisions of this Act, taken by a person under a dealing registrable, or which when appropriately signed by or on behalf of that person would be registrable under this Act shall, before registration of that dealing, be deemed to be a legal estate.

As Taylor J states in *IAC (Finance) Pty Ltd v Courtenay* (1963) 110 CLR 550at 583, many have attempted to find a satisfactory answer to the meaning of this section, which if "read literally… accomplishes nothing". His Honour rejects the argument that the section effectively confers an indefeasible title on the holder of a registrable dealing that is as yet unregistered, rejects the idea that the section was truly directed only at protection against notice, and instead adopts the contention that the section can

> operate to give the holder of a registrable memorandum of transfer priority over an earlier equitable interest where he has, without notice thereof, paid his purchase money and obtained his registrable instrument… the holder of a registrable instrument in such circumstances is enabled to assert, as against the prior equitable interest, that he is, therefore, entitled to perfect his title by registration

This approach was affirmed as correct by the entire High Court in *Meriton Apartments Pty Ltd v McLaurin & Tait (Developments) Pty Ltd* (1976) 133 CLR 671 at 676.

"Dealing registrable" is not defined, but it is presumably (apart from the lack of need for the holder of the instrument to execute that instrument) synonymous with a dealing in "registrable form" as referred to in s 36(6) of the Act. S 36(6)(b)(ii) provides that

> (b) a dealing shall be deemed not to be in registrable form:
>
> (i) unless the Registrar-General has authority to use, for the purpose of registering the dealing, the relevant certificate of title.

As *Fisher & Lightwood's Law of Mortgage* Australian Edition suggests at [28.13], it thus appears that a person does not obtain the protection of s 43A unless the person not only holds the dealing itself, but also has control of the certificate of title. This requirement greatly limits the circumstances in which s 43A is likely to come into play. This is especially so in the case of unregistered mortgages, as usually the main reason such mortgages are not registered immediately after settlement is the lack of availability of the certificate of title.

The Court of Appeal in Jonray (Sydney) Pty Ltd v Partridge Bros. Pty Ltd [1969] 1 NSWR 621 held that a void dealing is not a "registrable instrument" under s 43A. Thus even when the holder of an unregistered instrument has control of the certificate of title the holder is not in as good position as a registered proprietor in two respects: firstly, the holder of the unregistered instrument is affected by prior equitable interests of which the holder has notice; and secondly, there is no protection afforded to the holder of the unregistered instrument if the instrument is void by reason of forgery, duress, undue influence or non est factum. The holder is, however, at least protected from prior equitable interests of which the holder did not have notice.

D. Priorities between equitable interests

1. Equitable interests are enforceable

Although one might think from reading s 41 of the Real Property Act that no mortgage or any other dealing with respect to land could have any effect except by virtue of being registered, the section has never been interpreted in that fashion. In *Barry v Heider* (1914) 19 CLR 197, Isaacs J stated at 216:

> … sec. 41, in denying effect to an instrument until registration, does not touch whatever rights are behind it. Parties may have a right to have such an instrument executed and registered; and that right, according to accepted rules of equity, is an estate or interest in the land. Until that instrument is executed, sec. 41 cannot affect the matter, and if the instrument is executed it is plain its inefficacy until registered- that is, until statutory completion as an instrument of title- cannot cut down or merge the pre-existing right which led to its execution.
>
> The basis of the contention [that an unregistered dealing is of no effect] therefore fails, and we have to consider the position as to equitable remedies as if the land were not under the Statute.

Thus unregistered dealings relating to Real Property Act Land are accorded the same status as equitable interests under Old System Title, and their relative priorities are thus determined under the general law.

2. First in time prevails

The key maxim that is applied to determine the relative priorities of equitable interests in land is the Latin phrase "*qui prior est in tempore, potior est in jure*". The literal word-for-word translation of this maxim would be "who first is in time, stronger is in right", but this maxim is often transformed into the more helpful English maxim "When the equities are equal, the first in time prevails". This means that unless there is some other reason to prefer one equitable interest over another, priority will be given to the equitable interest that arose first in time. The question of determining priorities between equitable interests thus ultimately reduces to the question of whether there is sufficient reason in any given case to depart from the general rule that the first in time prevails.

3. Exceptions to the first in time rule

Although the list of circumstances where the "first in time" rule will not apply is by no means closed, there are several well-established situations where the rule has been held to be ousted, including:

1. Where the holder of the later interest is induced by the conduct (usually in the form of inaction) of the holder of the earlier interest into believing that no earlier interest exists;
2. Where the prior interest can be classed as a "mere equity", whilst the later interest does not fall into that category;
3. Where the holder of the earlier interest obtained that interest by way of gift, whilst the holder of the later interest obtained that interest for value and without notice of the earlier claim- as the maxim goes "Equity will not assist a volunteer"; or
4. Where the holder of the earlier interest has expressly waived priority over a later interest.

The first two of the above merit examination.

4. Postponing conduct

If a person holding an equitable interest, by his conduct, misleads a second person into believing that no such earlier interest exists, and the so believing the second person is thereby induced to acquire an equitable interest in the land for valuable consideration, then the conduct of the first person has the effect of "postponing" the priority of the earlier equitable interest, so that the later interest has priority.

i) Failure to caveat

One way in which such postponing conduct can occur is if the holder of the earlier interest could be reasonably expected to lodge a caveat to protect that interest, but refrains from lodging that caveat (or lodges the caveat after the later interest has already been created) and thereby induces the person who later comes to acquire a subsequent interest to act to his detriment. This may occur if the second person is seeking to acquire an interest in the land for value (such as prospective mortgagee), prior to acquiring that interest searches the title, assumes by the absence of any caveat that no prior equitable interest exists, and then proceeds to acquire the later interest in ignorance of the existence of the earlier interest. That was the situation in High Court decision of *Butler v Fairclough* (1917) 23 CLR 78, in which the holder of an unregistered charge over a lease was late in caveating, resulting in another person entering into an agreement to purchase the lease in reliance upon the clear title.

ii) Arming the registered proprietor

The Privy Council decision of *Lapin v Abigail* (1934) 51 CLR 58, involved a contest between two equitable interests, each arising under a loan transaction. The registered proprietors of Real Property Act land, the Lapins, had entered into an agreement with lenders whereby the lenders would advance money not secured by a Real Property Act mortgage, but rather in a manner similar to an Old System Title mortgage, in that

the title of the security was transferred to a nominee of the lender, Heavener, with Heavener becoming the registered proprietor of the security but with the Lapins possessing an equity of redemption whereby they could procure a reconveyance of the security upon discharge of the loan. By virtue of this transaction, the Lapins no longer appeared on the register, and did not lodge a caveat to protect their equitable interest. Heavener then proceeded to borrow money from Abigail, granting to Abigail a mortgage over the property by way of security. The mortgage was taken by Abigail in ignorance of the equitable interest of the Lapins. Before the mortgage could be registered the Lapins, belatedly, lodged a caveat preventing the registration of the mortgage. The Privy Council held that in that transferring the security to Heavener and then failing to caveat, the Lapins had allowed Heavener to represent herself as being the absolute owner of the property, and that Abigail had relied on this being the position when taking the mortgage. Their Lordships then determined that, in the circumstances, the Lapins were guilty of postponing conduct, so that the equitable interest of Abigail now had priority over the Lapins earlier equitable interest.

iii) Failure to caveat not fatal where the certificate of title is held

In *J & H Just (Holdings) Pty Ltd v Bank of NSW* (1971) 125 CLR 546, the High Court stated (p 554) that the mere failure to lodge a caveat did not in itself amount to postponing conduct, but that postponing conduct would exist in

> situations in which such a failure may combine with other circumstances to justify the conclusion that "the act or omission proved against" the possessor of the prior equity "has conduced or contributed to a belief on the part of the holder of the subsequent equity, at the time when he acquired it that the prior equity was not in existence"…

The quoted phrases were taken from the High Court's decision in *Lapin v Abigail* (1930) 44 CLR 166 at 183-184, which decision had been overruled by the previously mentioned Privy Council decision.

In *J & H Just (Holdings)*, the earlier equitable interest was an unregistered mortgage by the Bank of NSW, which mortgage was supported by handing to the Bank the certificate of title, but the Bank did not lodge a caveat to protect its mortgage. A second mortgage transaction later took place pursuant to which another lender advanced monies and took a mortgage after a title search has revealed a clean title. The Bank then, belatedly, lodged a caveat preventing the registration of the subsequent mortgage. The Court determined that, in the circumstances of the case before it, the mere failure of the Bank to caveat did not constitute postponing conduct, lodging a caveat being a primarily a protective measure rather than a means of notifying the world of one's interest, and with the Bank having retained the certificate of title and being able to reasonably rely on the possession of the certificate of title to prevent registration of subsequent interests. The absence of the certificate was indeed a matter of which the subsequent mortgagee was aware, and the mortgagee knew the certificate of title was held by the Bank, but the mortgagee had accepted without making any enquiries of the Bank the story of the mortgagor that the Bank was merely holding the document "for safe keeping" and that there was no prior encumbrance.

iv) Appropriate due diligence for an equitable mortgagee

It follows from the above that a prospective equitable mortgagee cannot merely rely on the absence of any caveat as a guarantee that the equitable mortgage will have priority over any prior equitable interests, but should the prospective mortgagee prior to entering into the mortgage be aware of some suspicious circumstance (such as the absence of the certificate of title), the mortgagee cannot be confident of priority, particularly if the mortgagee has failed to make proper enquiry into those circumstances.

v) Order of lodgment of caveats inconsequential

It is important to note that unlike the case with respect to the order of registration of dealings, the order of lodgement of caveats protecting unregistered interests (and, indeed, their order of appearance on the register) does not in itself confer any priority of one over the other. If a person with an equitable mortgage initially fails to caveat with respect to that mortgage but then later lodges a caveat after a subsequent mortgagee has taken an equitable mortgage in reliance upon the lack of caveats, the mere fact that the prior mortgagee might then lodge a caveat to protect the earlier mortgage prior to the lodgement of a caveat by the later mortgagee would not in any way assist the first mortgagee in the contest of priorities (which, on the stated facts, would likely be resolved in favour of the subsequent mortgage).

5. Mere equities

The concept of the subordinate status of a "mere equity" was addressed in the High Court decision of *Latec Investments v Hotel Terrigal* (1965) 113 CLR 265. The three judgements delivered in that case varied in their reasoning, but the judges concurred as to the resulting priorities. In *Ruthol Pty Ltd v Mills* (2003) BC200301187, the NSW Court of Appeal applied *Latec Investments* in determining priorities, the Court however declining to favour expressly any one of the three judgements in *Latec Investments* in determining priorities.

A "mere equity" is a type of equitable interest, but a form of interest that will rank lower in priority to the more usual type of equitable interest, even if the "mere equity" was created prior in time. A person holds a "mere equity" in circumstances where the person holds an equitable interest of a type that requires a court of equity to intervene to perfect in some way the holder's title to that equitable interest. As this is a difficult concept to explain (particularly given judicial disagreement on its details- Taylor J in *Latec Investments* indeed rejecting altogether the characterisation of the relevant interest in that case as a "mere equity"), it is necessary to look at examples.

In *Latec Investments*, a mortgagee of Real Property Act land in purported exercise of its power of sale, conspired with another party to ensure that the auction of the security land was unsuccessful, with the mortgagee's co-conspirator then purchasing the land by private sale at slightly above the maximum bid at auction. The purchaser then granted an equitable charge over the land to a third party, who gave value for the charge without notice of the prior fraud. In due course the mortgagor sought to set aside the fraudulent transfer to the purchaser, and had there been no third party interest the mortgagor would have been entirely successful on the grounds of the fraud. The Court determined, however, that the equitable interest of the chargee had priority over the equity of the mortgagor. Although the mortgagor's interest was prior in time, the equities were said not to be equal as the mortgagor merely had the right

(referred to by Kitto J as a "mere equity") to approach a court to set aside the conveyance of the property at law, whilst the third party had a full equitable interest in the usual meaning of the words, being an equitable charge.

In *Ruthol Pty Ltd v Mills*, Ruthol was a proprietor of land and granted an option to buy that land to Mr and Mrs Mills. The grant of an option confers an equitable interest in the holder of that option so long as the option may be exercised. The option could only be exercised within a stated period, and the Mills did not exercise their option within that period. Their failure to exercise was, however, induced by misrepresentations made by Ruthol. Ruthol then granted a new option to purchase to a third party, Tricon, who gave value for the option without notice of Ruthol's misconduct or any interest being claimed by the Mills. The Mills ultimately discovered Ruthol's misconduct and purported to exercise their option out of time. Tricon also sought to exercise its option, but it exercised its option within the time specified for the Tricon option. There then arose a priority contest between the Mills and Tricon. The Mills' interest arose first in time, but as the Mills needed to rely on equity to enable them to exercise their option outside their option period, Tricon's equitable interest was held to have priority over the Mills' "equity".

E. Priorities between leases and mortgages

1. If both lease and mortgage are registered

If both mortgage and lease are registered, then if the lease is registered before the mortgage, the lease has priority. If the mortgage is registered first it will have priority unless the mortgagee has consented to the lease, as s 53(4) of the Real Property Act provides:

> A lease of land which is subject to a mortgage, charge, or covenant charge is not valid or binding on the mortgagee, chargee or covenant chargee unless the mortgagee, chargee or covenant chargee has consented to the lease before it is registered.

2. If the mortgage is registered and the lease is not registered

A registered mortgage has priority over an unregistered long term lease (being of greater than 3 years, including any option periods). A registered mortgage has priority over a short term lease only if the mortgagee did not have notice of the lease prior to registration (Real Property Act s 42(1)(d)).

3. If the mortgage is unregistered and the lease is registered

If the mortgage is unregistered, a prior registered lease will have priority over it by virtue of the latter's indefeasibility. If an unregistered mortgage is first in time but did not consent to the lease, then as s 53(4) of the Real Property Act only protects registered mortgagees, the subsequent registered lease will still have priority over it by virtue of the latter's indefeasibility.

4. If the mortgage is unregistered and the lease is unregistered

A prior unregistered short term lease (a term of 3 years or under) is a legal interest and will thus have priority over an unregistered mortgage (an equitable interest) absent fraud or gross negligence on the part of the tenant leading to the creation of the mortgage. A subsequent short term lease, being a legal interest, will rank in priority

ahead of a prior unregistered mortgage if the lease was obtained for value, in good faith, and without notice of the mortgage, but otherwise the mortgage will have priority.

An unregistered long term lease is an equitable interest. In any competition between an unregistered long term lease and an unregistered mortgage, the first in time will have priority unless the holder of the first interest in time is guilty of postponing conduct, or if the holder of the second interest took for value and without notice of the first interest and holds a registrable dealing and the certificate of title to enable registration to occur (s 43A of the Real Property Act).

F. Tacking

1. What is tacking

"Tacking" is the traditional name for the ability of a first mortgagee of Old System land to use that first mortgage to obtain priority over subsequent mortgagees and chargees for other monies advanced after the security was subsequently encumbered. Such other monies were then said to be "tacked" onto the first mortgage.

2. How does tacking arise?

Tacking might arise either when the first mortgagee made further advances under the first mortgage, or when, by reason of transfer, the same mortgagee came to hold both a first mortgage and a third (or subsequent) mortgage. In this latter case, the usual course of events was for the third mortgagee to acquire a transfer of the first mortgage so as then to enjoy priority over the second mortgage not only in relation to monies advanced under the first mortgage, but also in relation to monies advanced under the third mortgage, which was thereby promoted ahead of the second mortgage. This doctrine of promotion of the third mortgage is referred to as *tabula in naufragio*, meaning "plank in a shipwreck", and presumably referring to the fact that the third mortgagee is saved from mere third priority by virtue of the "plank" being the first mortgage.

3. Tacking under old system

Tacking was already well established by the seventeenth century, with the principles apparently well known by the time of *Marsh v Lee* (1670) 86 ER 473 and *Brace v Duchess of Marlborough* (1728) 24 ER 829, which applied the law of tacking and were able to cite many prior authorities supporting it. Tacking was once explained by the so-called "doctrine of estates", referring to the special status enjoyed by a first mortgagee under Old System Title, with the first mortgagee being effectively the proprietor of the security, and the mortgagor having merely an equity of redemption enabling the mortgagor to re-acquire the security from the mortgagee on discharge of the mortgage. Under Old System Title, second and subsequent mortgagees held no legal interest, as the mortgage was not over the land itself (which the mortgagor no longer owned at law) but were rather mortgages over the mortgagor's equity of redemption, and hence equitable rights only. By virtue of the general doctrine that legal rights enjoy priority over equitable rights, the first mortgagee was thus in a special position.

The special distinction enjoyed by the first mortgagee under Old System Title by virtue of the doctrine of estates is well illustrated in *Brace v Duchess of Marlborough*

(1728) 24 ER 829, in which a mortgagee low in the order of priority- a "puisne (petty) incumbrancer" purchased what was thought to be the first mortgage in order to tack the puisne mortgage to the first mortgage and thus gain priority over all earlier mortgagees. The puisne incumbrancer blundered, however, as set out at 831:

> In this case it appeared that a puisne incumbrancer bought in a prior mortgage, in order to unite the same to the puisne incumbrance, but it being proved that there was a mortgage prior to that, the Court clearly held that the puisne incumbrancer, where he had not got the legal estate, or where the legal; estate was vested in a trustee, could there make no advantage of his mortgage; but in all cases where the legal estate is standing out, the several encumbrances must be paid according to their priority in point of time.

4. Tacking under the Real Property Act

The Torrens System removes the unique position of the first mortgagee that existed under Old System Title, so that the interest of first registered mortgagee is no longer different in kind to that of subsequent registered mortgagees. The first registered mortgage still has priority, but all registered mortgages of Torrens System land are legal mortgages conferring similar rights and remedies against the mortgagor. Notwithstanding the removal of the special distinction enjoyed by the first mortgagee, the tendency of courts to continue to apply Old System Title principles in many cases notwithstanding the changed circumstanced created by Torrens System legislation has caused the doctrine of tacking (in its modern, limited form) to survive, with authorities such as *Matzner v Clyde Securities Ltd* [1975] 2 NSWLR 293 and *Central Mortgage Registry of Australia Ltd v Donemore Pty Ltd* [1984] 2 NSWLR 128 holding that the doctrine (as least in relation to the tacking of further advances) was still applicable, even in the case of registered mortgages over Real Property Act land, as it was said to be "founded on principles of justice and fair dealing as between the mortgagor and the mortgagees, and as between the competing mortgagees" (*Matzner* at p 300). Given the above recasting of tacking, it follows that it must now be no longer confined to first mortgagees, but presumably any mortgagee can invoke the doctrine in appropriate circumstances.

5. Has *Tabula in Naufragio* survived in New South Wales?

Whether the *tabula in naufragio* (plank in a shipwreck) variety of tacking has also survived Torrens legislation in the same way that tacking of further advances has survived is not altogether clear. Whalan in *The Torrens System in Australia*, 1982, pp 170-1, concludes that *tabula in naufragio* has not survived, as now all registered mortgaged confer a legal estate, not just the first mortgage. The Australian Edition of *Fisher & Lightwood's Law of Mortgages*, at [25.15], notes however that this reasoning would only apply in so far as it excludes tacking by subsequent registered mortgagees, but that presumably a subsequent equitable mortgagee without notice of an intervening equitable interest could tack the equitable mortgage to a transferred registered mortgage, as this would be the traditional case of the holder of an equitable interest being promoted by the acquisition of a legal interest.

The New Zealand single judge decision in *Kerr v Ducey* [1994] 1 NZLR 577 stated that *tabula in naufragio* no longer applied in post-Torrens Title New Zealand (although the ability to tack further advances remained), then finding that the facts of the case before the court did not fit within the doctrine in any event. The court noted

in relation to *tabula in naufragio* that under the Torrens System a "registered mortgage would not give a legal estate in the mortgaged land, merely a registered charge on the land". In New Zealand, however, s 80A of the Property Law Act 1952 (NZ) expressly modifies the law in relation to tacking of mortgages; this provision is also reflected in the Victorian, Queensland and Tasmanian Torrens legislation (and in UK legislation, from which the New Zealand provision was itself taken), but there is no equivalent in New South Wales. For this reason *Kerr v Ducey* is of little assistance in determining the law in New South Wales.

In *Bank of Western Australia v Connell* (1996) 16 WAR 483, the Western Australian Supreme Court notes (p 498) that *tabula in naufragio* is dependent on the doctrine of estates, whilst post *Matzner* the tacking of further advances is not dependent on that doctrine. Beyond concluding that arguments by analogy from the *tabula in naufragio* principle are of no use when considering the matter of tacking further advances, however, the Court makes no finding on the persistence of *tabula in naufragio* in Western Australia, although the failure of the Court to reject the doctrine may be seen to give some encouragement to the notion that the doctrine does indeed still remain.

It is thus likely, but by no means certain, that the *tabula in naufragio* doctrine continues to apply in New South Wales in relation to mortgages, but only in relation to the question of priority between unregistered mortgages.

It should be noted that quite apart from the doctrine of *tabula in naufragio*, a subsequent mortgagee is always entitled to purchase the first mortgage from the first mortgagee and then to proceed against the mortgagor under that first mortgage with priority to all other mortgages, but absent the operation of *tabula in naufragio*, the mortgagee's priority is limited to the monies due under the first mortgage and does not include debts due under any subsequent mortgages.

6. The limits of tacking of further advances

Although the tacking of further advances remains part of the general law of New South Wales, the circumstances in which tacking can occur are limited. In *Hopkinson v Rolt* (1861) 11 ER 829, the House of Lords determined that tacking of further advances was only permissible in circumstances where the further advance in question was made without the mortgagee having notice of any subsequent encumbrances. In *West v Williams* [1899] 1 Ch 132, it was decided that notice of a subsequent encumbrance prevented tacking of further advances even when the first mortgage obliged the mortgagee to make those further advances, and obliged the mortgagor to receive them.

The rule in *Hopkinson v* Rolt remains applicable in New South Wales, although the rule as it was applied in *West v Williams* has been challenged in *Matzner v Clyde Securities Ltd* [1975] 2 NSWLR 293, with *West v Williams* being distinguished. *Matzner* thus warrants closer examination to determine the correct rule in New South Wales.

In *Matzner v Clyde Securities Ltd*, Holland J was obliged to determine a question of priorities between three registered mortgagees of Real Property Act land. The first mortgages was expressed to be security for a $273,600 "principal sum" to be loaned to the mortgagor, but which the mortgagor was obliged "to accept the whole of the

principal sum" in instalments. There was no fixed timetable for the advances to be made, but the mortgagor could apply for "progress payments" at any time so as to compel the mortgagee to advance further monies so as to bring the total funds advanced up to 73.4% of the aggregate value of the mortgaged land and the cost price of labour and materials used in the improvement of the mortgaged land. The second and third mortgages, however, were registered prior to all of the principal sum being advances, and there was thus a question as to whether the first mortgagee had priority for advances of principal made after the registration of those subsequent mortgages.

His Honour noted the rule established by *West v Williams* [1899] 1 Ch 132 that a first mortgagee cannot claim priority for subsequent advances made after notice of a second mortgage (in other words, engage in "tacking" the subsequent advances to the first mortgage) even when the first mortgage obliged the mortgagee to make further advances and obliged the mortgagor to accept them. His Honour, however, distinguished *West v Williams* on the basis that in the case before him the further advances were being applied to improve the property and so allowing the first mortgage to tack those advances to the first mortgage should not be to the prejudice of the subsequent mortgagees.

Matzner v Clyde Securities Ltd does not seek to overturn *West v Williams* generally, but simply to allow tacking in the cases of building mortgages obliging further advances to be made and accepted, when the further advances are likely to result in an improvement in the value of the security property: see *Philos Pty Ltd v National Bank* (1976) 5 BPR 11,810 at 11,815. *Matzner* can thus be seen as doing no more than applying the principal in *Shepard v Jones* (1981) 21 Ch D 469 that in the case of a mortgagee paying for improvements upon the security, then even if there is no consent or acquiescence by other interested parties, the mortgagee is nevertheless entitled to be repaid the cost of the improvements to the extent they have enhanced the value of the security. *West v Williams* thus, presumably, continues to hold good in cases where the further advances are not applied to improvements in the value of the security.

In the course of the judgement in *Matzner*, Holland J cited (p 303) a passage from Hogg's *Conveyancing and Property Law in New South Wales* (1909) stating:

> The only safe course for a mortgagee proposing to advance money by installments seems to be, that the actual arrangement which is contemplated should be sufficiently set out in the mortgage instrument, and the mortgagor bound by a special covenant to accept the proposed advances from his intended mortgagee, and no one else. In the absence of these precautions, a first mortgagee could, it seems, only have priority for the amount actually advanced at the time of the second mortgagee giving notice.

His Honour then impliedly approves that passage, although noting that despite doubts raised by the author of the passage, the rule would also extend to allow a first mortgagee priority with respect to progress payments made under a building mortgage in the circumstances of the case before him. To the limited extent *Matzner v Clyde Securities Ltd* allows tacking of further advances after notice of a subsequent mortgage, it would thus appear that such tacking can only occur when there are express provisions in the mortgage obliging the mortgagee to advance and the

mortgagor to accept further advances. If the mortgagor is not obliged to draw down all of the specified principal sum, then it would appear that no tacking of subsequent advances would be permitted, even if the mortgage was otherwise found to fall within the ambit of the *Matzner v Clyde Securities Ltd* exception to *West v Williams*. The point is, however, probably a moot one, as *Matzner* appears only to apply in cases where the further advances are used to enhance the value of the security, and to the extent the value is enhanced such monies are recoverable as a priority in any event under the doctrine in *Shepard v Jones*, regardless of whether the mortgagee was obliged to advance (or the mortgagor obliged to accept) the advances in question.

7. Prevention of tacking

As tacking of either description at the expense of an unregistered mortgage is not possible if notice of that mortgage has been given (the *Matzner v Clyde Securities Ltd* exception to the rule against tacking with notice being limited to situations in which subsequent mortgagees will not be prejudiced in that the further advances are used to improve the security), a prudent unregistered mortgagee should attempt to bring the unregistered mortgage to the notice of any registered mortgagees. The easiest method to affect such notice is to lodge a caveat on the title in question, although a written notice to the registered mortgagees might be employed in lieu or in addition. It follows that a mortgagee considering making further advances should search the title for caveats to avoid advancing such monies notwithstanding constructive notice of a subsequent encumbrance, with the subsequent encumbrance thus taking priority over the repayment of the further advances.

G. Marshalling

1. The general principle

Marshalling is a general law equitable principle that provides that if there are two secured creditors, with the prior security-holder having security over two assets of the same debtor and the subsequent security-holder having security over one of those assets but not the other, then if those assets be sold the prior security-holder should satisfy itself first from the proceeds of the asset over which the subsequent security-holder holds no security, and only to the extent that there is a shortfall after realisation of that asset may it satisfy itself from the proceeds of the asset that is subject to both securities. This doctrine applies to all securities, including mortgages over Torrens System land: see *Bank of NSW v City Mutual Life Assurance Society Ltd* [1969] VR 556.

2. Where there is a third security holder on the other property

Marshalling will not, however, be applied to the detriment of a third security-holder. Thus a first mortgagee cannot, at the behest or one second mortgagee, satisfy itself from another property in which the second mortgagee has no interest, if there is another second mortgagee interested in that second property who would thereby be prejudiced. In this instance the first mortgagee should not favour either second mortgagee, but recover from each of the properties pro rata according to their value. Marshalling also is not available if the prior security holder is obliged by contract (such as the terms of a mortgage) to realise securities in a particular order.

3. Remedies available to the aggrieved subsequent mortgagee

To the extent that a prior security-holder satisfies itself in a manner contrary to the doctrine of marshalling by proceeding first against an asset shared with a subsequent security-holder and only later (if at all) against a second asset, a right that has been described as "akin to subrogation" then arises in favour of the subsequent security-holder against the prior security-holder, which enables the subsequent security-holder to stand in the position of the first security-holder and proceed against the second asset and to pay out of the proceeds of the second property such monies as the subsequent security-holder should have received out of the first property if the prior security-holder had satisfied itself in the correct manner. The subsequent security holder does not, however, obtain an equitable interest in the second property itself. A subsequent security-holder also lacks the right to compel the prior security-holder to realise the prior holder's securities in any particular order, and the prior security-holder retains freedom of choice in this regard unless constrained by the terms of the securities themselves: see *Mir Projects Pty Ltd v Lyons* [1977] 2 NSWLR 192. Further, if the prior-security holder discharges the other security, the subsequent security holder is left without a remedy.

4. Example

Suppose there are three lenders, A, B and C, each of whom separately lend money to the same debtor. The debtor has 3 properties: X, Y and Z. Suppose that A is the first to lend, advancing the sum of $600,000 to the debtor and taking a first mortgage over all three properties. B then lends $500,000 to the debtor, taking as security a second mortgage over property X. C then lends $200,000 to the debtor, taking a second mortgage over property Y. Assume further there are no other encumbrances over X, Y, or Z. The debtor then defaults under all of the mortgages and the three lenders all seek to recover their monies. To facilitate this, all three properties are sold, with the sale of X netting $600,000, Y netting $400,000, and Z $400,000.

In these circumstance, lender A should first take the $400,000 from the sale of Z, as that is to the prejudice of neither of the other mortgagees. There is still $200,00 to recover, however, so this should be recovered from properties X, and Y in proportion to their relative values, so 60% (being $120,000) must come from X and 40% (being $80,000) from Y. With A now paid in full, B takes the remaining $480,000 from the proceeds of X, and so has a shortfall of $20,000 (which cannot be satisfied out of property Y as B has no security over that property). C takes $200,000 out of the remaining proceeds of Y and is thereby satisfied in full, with $120,000 surplus being paid to the debtor. This surplus will be useful to the debtor, as the debtor is still liable on his personal covenant to B for the shortfall on B's mortgage of $20,000.

Let us now suppose instead that the three properties are not sold together but lender A instead causes X to be sold first, and A completely satisfies itself out of the proceeds, leaving nothing for B. B has no right to seek an injunction to prevent this conduct on the part of A, however B does now have a right to stand in A's shoes and to sell Y and Z, and thus obtain the funds to pay to B the sum of $480,000 B should have received out of the proceeds of X. B's right is only *in personam*, however, B would not have a caveatable interest over either Y or Z, but could only enforce its right in a personal suit against A.

H. Notice

1. Actual notice

"Actual notice" of a prior interest in land is the state of affairs where a person actually knows of the existence of the interest. This state of affairs can arise if "express notice" is given of the interest- where the person in question has been expressly informed of the existence of that interest, whether orally or in writing. Actual notice can, however, arise without express notice, as a person can become aware of the fact without being informed of the fact in a direct manner: see *Lloyd v Banks* (1868) LR 3 Ch App 488. To prove actual notice, one must prove that person in question knew of the interest in question, one is not obliged to prove that the information came to the person by any particular mode (although without express notice it may be more difficult to demonstrate the person's knowledge).

2. Constructive notice

"Constructive notice" becomes an issue when the evidence is insufficient to prove actual notice of the interest (whether because there was no actual notice or the person does not admit such notice and it cannot otherwise be proved). Constructive notice of an interest is held to be present when the person in question would have received actual notice if the person had made the normal enquiries that would be made by a reasonable person in the same position. These enquiries might either be the standard enquiries made in every transaction relating to land, such as searching the register and inspecting the property; or be such additional enquiries as are reasonably necessitated by "actual notice of some defect, inquiry into which would disclose others": *Bailey v Barnes* [1894] 1 Ch 25 at 35. One instance of constructive notice occurring pursuant to the above principal is that actual notice of an instrument is also deemed to be constructive notice of the contents of an instrument.

In *Butler v Fairclough* (1917) 23 CLR 78 at 91, Griffiths CJ stated:

> A person who has an equitable charge upon the land may protect it by lodging a caveat, which in my opinion operates as notice to all the world that the registered proprietor's title is subject to the equitable interest alleged in the contract.

The statements in *J & H Just (Holdings) Pty Ltd v Bank of NSW* (1971) 125 CLR 546 previously alluded to, being to the effect that the primary purpose of a caveat is as a protective measure not as a means of giving notice, should not be read as contradicting the above proposition, being that the lodgement of caveat is sufficient then to give notice to all the world of the interest in question. The thrust of *J & H Just (Holdings)* was not to the effect that a caveat is insufficient to give notice to the world of an interest, but rather to the effect that a person is not obliged to give notice by way of lodging a caveat (on pain of being postponed to a subsequent interest) if the person has taken other reasonable steps to secure the person's position. Thus the lodgement of a caveat is sufficient but not necessary condition for providing notice to all other persons, and thus that lodgement should be viewed as another fashion in which constructive notice can be given.

The existence of the concept of constructive notice prevents a person from obtaining a priority advantage by refraining from conducting such enquiries as are usual in the

circumstances, or refraining from investigating such matters that may come to the person's attention which would prompt investigation by a reasonable person in the same position. Exactly what matters a person will be taken to have constructive notice of will vary from case to case, but will include the contents of the register itself and the contents of any dealings registered or instruments referred to in caveats that have been lodged.

3. Imputed notice

"Imputed notice" of an interest exists where the agent of a person has either actual or constructive notice of an interest. The notice received by the agent is then imputed to the person, whether or not the agent ever saw fit to inform the agent's principal of the interest.

4. Significance of different categories of notice

S 164 (1) of the Conveyancing Act is entitled "Restriction on constructive notice" and states:

> A purchaser shall not be prejudicially affected by notice of any instrument, fact or thing, unless-
>
> (a) it is within the purchaser's own knowledge, or would have come to the purchaser's knowledge, if such searches as to instruments registered or deposited under any Act of Parliament, inquiries, and inspections had been made as ought reasonably to have been made by the purchaser; or
>
> (b) in the same transaction with respect to which a question of notice to the purchaser arises, it has come to the knowledge of the purchaser's counsel as such, or of the purchaser's solicitor or other agent as such, or would have come to the knowledge of the purchaser's solicitor or other agent as such, if such searches, inquiries, and inspections had been made as ought reasonably to have been made by the solicitor or other agent.

"Purchaser" is defined in s 7 of the Act to include a mortgagee. Such provisions as s 164, however, only establish how notice can be given as a matter of law rather than as matter of equity, and so have no application in relation to equitable interests: see *ER Investments Ltd v High* [1966] 2 QB 379. S 164 thus only restricts the manner in which the holder of a legal interest can be fixed with notice of a prior legal interest, and has no wider application. In any event, s 164 is not much more restrictive than the general law, as it allows imputed notice and most forms of constructive notice.

Except in the limited circumstances in which s 164 is operative, a person is deemed to have notice of a matter if the person has actual notice, constructive notice, or imputed notice. There is thus usually little importance in categorizing the type of notice provided in any given case, as all types are equally effective.

I. Bankruptcy of the mortgagor

1. Generally a mortgagee has priority over unsecured creditors

Unsecured creditors of a bankrupt rank in priority below all secured creditors of the bankrupt. There is, however, a statutory ability conferred on a trustee of a bankrupt in limited situations to set aside certain past dealings with the bankrupt's property to the

extent that those dealings would otherwise affect the trustee. If a mortgage (or part or all of the debt secured by a mortgage) was set aside by this means, the mortgagee would not only lose (or lose in part) its priority over the unsecured creditors, but could then effectively rank behind the unsecured creditors, in whole or in part.

2. However mortgages can be set aside as against the trustee in bankruptcy

The sections of the Bankruptcy Act that could result in the setting aside of a mortgage as against a trustee are considered below:

i) Sections 120 and 121

Sections 120 and 121 of the Bankruptcy Act permits the trustee of a bankrupt to make void certain transfers of property (the definition of which includes the grant of a mortgage) if full value was not given by the transferee. In order to take advantage of these sections, however, the trustee has to repay to the transferee all consideration that the transferee gave to the bankrupt. As the granting of a secured loan almost by definition presupposes the lender giving full value for the creation of the mortgage interest in the security property (even if the loan secured is an old one, then the mortgagee is presumably giving consideration in the form of forbearance to sue or extension of a loan facility), it is difficult to imagine a situation in which these sections could cause any difficulty for a mortgagee.

ii) Section 122: unfair preference

S 122 provides that transfers of property by an insolvent person in favour of a creditor is void against the trustee if the transfer "had the effect of giving the creditor a preference, priority or advantage over other creditors" and was made with the prescribed period. In the case of a bankruptcy resulting from a creditor's petition, the prescribed period commences six months prior to the presentation of the petition and ends on the day the bankruptcy order is made. Subsection (2) (a), however, protects from the operation of this section "a purchaser, payee or encumbrancer in the ordinary course of business who acted in good faith and who gave consideration at least as valuable as the market value of the property". Subsection 4 (c) provides that "good faith" is deemed not to exist if:

> the transfer of property was made under such circumstances as to lead to the inference that the creditor knew, or had reason to suspect:
>
> (i) that the debtor was unable to pay his or her debts as they became due from his or her own money; and
>
> (ii) that the effect of the transfer would be to give him or her a preference, priority or advantage over other creditors.

In most mortgage transactions no preference will exist as the mortgagee will not be a pre-existing creditor of the mortgagor. If, however, a mortgage is granted to secure a formerly unsecured debt or a mortgage is granted which secures both an old unsecured debt and a new advance, then the mortgagee will have been preferred over other creditors to the extent that the formerly unsecured debt is now secured. Although a sub-section (2)(a) defence would be potentially open to the mortgagee in such a case, the fact that the creditor saw the need to secure the formerly unsecured debt might be taken by the court to suggest that the creditor had a suspicion that the debtor could not pay the former debt from his own monies, and thus "good faith"

would not be made out. An example of a mortgage being set aside (but only to the extent it secured a prior unsecured loan).

iii) Section 123: protection from relation back

S 123 protects, subject to certain earlier provisions, including sections 120 to 122, from being invalidated by the doctrine of relation back certain transactions, the specification of which would include the grant of a mortgage. Such transactions are protected if they took place before the actual sequestration order was made; the person other than the debtor (in the present case the mortgagee) had no knowledge of the presentation of a petition against the debtor; and the transaction "was in good faith and in the ordinary course of business". Subsection (2) provides that the mere knowledge by the other person (ie mortgagee) of the commission of an act of bankruptcy by the debtor (such as failure to meet a bankruptcy notice with payment) does not deem a transaction not to be in good faith and the ordinary course of business.

Thus if a mortgage is granted after an act of bankruptcy occurs, and a creditor's petition is presented within 6 months after the act of bankruptcy, and that petition ultimately results in a sequestration order being made, then the mortgage will be invalidated by the doctrine of relation back (which holds that from the relation back date the debtor is deemed not to have owned his property but for it to have been vested in the trustee), unless the mortgagee can establish the defence of "good faith and the ordinary course of business". In the context of s 123, "good faith" refers to the fact that valuable consideration is given, there was no collusive arrangement with the debtor, and there was otherwise no intent to defraud. The words "in the ordinary course of business" mean, essentially, that the non-debtor party is treating the transaction as any other normal transaction, and it is not entered into with suspected bankruptcy in view.

One would expect that the great majority of mortgage transactions would satisfy both tests of "good faith" and "in the ordinary course of business", but nonetheless there is still the potential for expense and delay in recovery caused by having to establish these matters if a trustee attempted to set aside the mortgage. Further, it should be borne in mind that if a creditor's petition is known by the mortgagee (or his agent) to have been presented then the defence of "good faith and in the ordinary course of business" is no longer available.

It is clear from the High Court's analysis on p 106 of the previously-cited *Burns v Stapleton* that mortgages are not immune from being set aside under the doctrine of relation back. In that analysis, the Court rules on the argument that the legal mortgage- which was entered into within the relation-back period- was invalidated *in toto* by reason that relation back of the bankruptcy meant that the bankrupt had no title to grant the mortgage at the time he purported to do so. The Court determines that the legal mortgage is not invalidated by the doctrine of relation back, but only because the security was previously subject to an equitable mortgage in favour of the creditor, and all that occurred during the relation back period was the transformation of an equitable mortgage into a legal mortgage.

3. Is it Better Not to Perform a Bankruptcy Search?

If a bankruptcy search is never performed, then the mortgagee has much less chance of realizing that a creditors petition has been presented (if that be the case) and thus will not have a s 123 defence invalidated by knowledge of the same. On the other hand, a deliberate policy of refusing to make bankruptcy searches in case one discovered a creditor's petition might negative the "good faith" component of the defence of "good faith and in the ordinary course of business". Further, without a bankruptcy search the risk is always run that a sequestration order has in fact been made against the mortgagor prior to the mortgage being executed, which would invalidate the mortgage as against the trustee notwithstanding the lack of knowledge. It is thus prudent for a prospective mortgagee to make bankruptcy search shortly before the mortgagee commits itself to the loan, and then to refuse to lend if the search reveals that a creditor's petition has been presented and is still current (or, of course, if the mortgagor is an undischarged bankrupt). If the bankruptcy search revealed a bankruptcy notice had been issued and not lapsed or been satisfied (or an act of bankruptcy by the debtor was known by some other means), then the possible complications if bankruptcy resulted might again induce a mortgagee not to lend, although the risks are far less than if a creditor's petition was known to have already been presented.

J. Foreclosure of Real Property Act land

S 61 of the Real Property Act permits a registered mortgagee of Real Property Act land to apply to the Registrar-General for foreclosure of that land when there has been default in the payment of interest or principal for six months and when the conditions in that section are satisfied. These conditions are that the land has been offered for sale at a public auction conducted by a licensed auctioneer after due notice was given to the mortgagor and other persons identified in s 57; that the amount of the highest bid was insufficient to discharge the mortgage; and notice of the foreclosure application has been made to the mortgagor, to all other mortgagees or chargees that are registered or who have lodged a caveat. S 62 provides that the Registrar-General may then either issue a foreclosure order or require the applicant to offer the land for sale again in accordance with the directions the Registrar-General gives with respect to the sale.

Presumably the giving of notice of the application to interested parties is to allow those parties the opportunity to seek to injunct the application if there is a dispute as to whether the pre-conditions have genuinely been met. This will ensure that foreclosure will not take place until a genuine attempt has been made to discharge the first mortgage through exercise of power of sale.

Under s 62(3) of the Real Property Act, the making and recording by the Registrar-General of an order for foreclosure has the effect of vesting the security in the mortgagee free of any subsequent mortgage or charge and free of any right of redemption of the mortgagor. As discussed above, however, this can only occur if there has been an unsuccessful attempt to discharge the first mortgage through exercise of power of sale.

K. Agreements regarding priority

1. Deeds of priority

Mortgagees are free to contract between themselves so as to adjust their relative priorities. There is indeed a common practice whereby a Deed of Priority is entered into between first and second mortgagees establishing clearly how the priorities are to lie between them. S 58(3) of the Real Property Act in no way limits the ability of mortgagees to contract between themselves in relation to their respective priorities, nor does it affect the enforceability of such contracts.

2. Representations regarding priority

Page 547 of the Australian Edition of *Fisher & Lightwood's Law of Mortgages* refers to the availability of an action by a subsequent creditor in negligence against a bank that has given an assurance that the bank's mortgage will be postponed to the interest of the subsequent creditor. In addition to an action in negligence, the detrimental reliance of the creditor on such an assurance would also give rise to an estoppel against the bank that would preclude the bank from asserting its priority in contradiction of its earlier assurance.

L. Notice of a trust by a mortgagee

1. Notice of a trust by a registered mortgage

Mere notice (of any type) of the existence of a trust will not affect a registered mortgagee's indefeasible title. If, however, the mortgagee is knowingly involved in a breach of trust then that may constitute fraud and cause indefeasibility to be lost.

2. Notice of a trust by an unregistered mortgage

Notice (of any type) of the existence of a trust by an unregistered mortgagee means that the beneficiary's interest is likely to have priority over the mortgagee's interest. The interest of a beneficiary under a trust is an equitable interest, and being first in time it is likely to be accorded priority over a later equitable mortgage in any event, but the fact of notice of the trust further reinforces the beneficiary's position as the fact of notice will prevent the mortgagee relying on s 43A of the Real Property Act (if that section was otherwise available) and will make it more difficult for the mortgagee to assert that the beneficiary has postponed the beneficiary's interest. A prospective unregistered mortgagee with knowledge of the existence of a trust should thus take particular care to ensure that the mortgage is no in breach of trust, including obtaining the consent to the mortgage in writing of any beneficiaries.

M. Surplus funds

1. Method of disposal

A mortgagee who has exercised power of sale and holds surplus funds after discharging the mortgagee's own mortgage (and any mortgage with greater priority to that mortgage) holds those surplus funds on trust for the persons entitled thereto. In many cases there will be persons other than the mortgagor who will be claiming entitlement to some or all of the surplus funds. In this case, the mortgagee should obtain agreement from all the claimants as to how the surplus is to be distributed. If

there is no agreement, and it is not altogether clear to the mortgagee which of the competing contentions is correct, the mortgagee can discharge its responsibility in relation to any disputed surplus funds by paying them into the Supreme Court pursuant to s 95(1) of the Trustee Act 1925.

2. Payment into court

If a mortgagee pays surplus funds to a person who is ultimately found not to have been entitled to those funds, then the mortgagee may be liable to the true beneficiary for breach of trust, and if the funds have since been dissipated the mortgagee may then have to make good the mistake out of its own pocket. This fact may make payment into court of surplus seem an attractive course, however there are limits to the use of this advice. A mortgagee should not simply pay all surplus funds into court automatically without first conducting a reasonable enquiry as to who may be entitled to those funds, as a trustee who pays money into court claiming inability to identify the proper claims of the beneficiaries when, in fact, there is no reasonable doubt on this matter may be ordered by the court to bear the costs associated with the payment of the money: *In re Elliot's Trusts* (1873) LR 15 Eq 194.

3. Tracing funds incorrectly dispersed

When a breach of trust occurs, the beneficiary has not only a personal remedy against the trustee (and against other persons knowingly involved in the breach of trust), but may also have a right *in rem* against the trust property, even if that property is no longer in the hands of the original trustee. This right *in rem* to follow trust property into the hands of third parties is referred to as "tracing" the trust property.

The rules relating to tracing are complicated, but generally speaking trust property can be traced into or through the hands of a volunteer or of a person with notice of the breach of trust, but not into or through the hands of a bona fide purchaser for value without notice: see eg *Re J Leslie Engineers Co Ltd* [1976] 2 All ER 85.

N. Order of registration

S 36(4) of the Real Property Act states:

> Where two or more dealings which affect the same land have been lodged and are awaiting registration, the Registrar-General may register those dealings in the order which will give effect to the intentions of the parties as expressed in, or apparent, to the Registrar-General from, the dealings.

S 36(5) then goes on to note that if the intentions of the parties to the dealings appear to conflict, the Registrar-General shall register them in the order that they were lodged.

The effect of these provisions is that dealings are registered in the order they are lodged except if each of the dealings that have been lodged make it clear that the parties want the dealings registered in a different order.

If the Registrar-General erroneously caused dealing to be registered in the incorrect order, this would be a matter that the Registrar-General could subsequently rectify the Register to show the correct order of dealings, pursuant to his power under s 12(d) of the Real Property Act to correct errors or omissions in the Register.

O. Writs

In relation to a writ recorded on title to land, s 105(1) of the Real Property Act makes clear:

> A writ, whether or not it is recorded in the Register, does not create any interest in land under the provisions of this Act.

S 105A(2) of the Act, however, operates to prevent any dealing being registered with respect to land within a period of 3 months after a writ is recorded over that land unless the dealing refers to the writ as a prior encumbrance. There are exceptions to this provision, but these exceptions do not include the registration of a mortgage. As the land may be sold pursuant to the writ within that 3 month period, and as a mortgagee may rightly be unwilling to wait up to 3 months for registration in any event, if a search of the register reveals that a writ has been recorded over land within the previous 3 months, a prudent prospective mortgagee should not proceed with mortgage lending unless and until the 3 month period has elapsed without the execution of the writ through sale of the property.

As a writ is not a interest in land, no priority question arises as between a mortgagee and the judgement creditor that has lodged the writ, although as stated above, the writ provides the statutory right to the judgment creditor to prevent other dealings from being registered within the next 3 months.

P. Land Tax

As provided by s 47(1) of the Land Tax Management Act 1956:

> Land tax shall until payment be a first charge upon the land taxed in priority over all other encumbrances whatever, and where the land tax comprises two or more parcels the land tax payable on the land taxed shall be a first charge on each and every such parcel and notwithstanding any disposition of the land or any part thereof the land or any part thereof the land or part shall continue to be liable in the hands of any purchaser or holder for the payment of the land tax so long as it remains unpaid.

Thus unpaid land tax constitutes a charge that ranks ahead of any mortgages, registered or otherwise, regardless of any considerations such as notice.

There is no reason in principal why the doctrine of marshalling would not apply in circumstances where land tax was charged against multiple parcels collectively comprising that land, if the parcels were otherwise encumbered differently.

Q. Council rates

S 550 of the Local Government Act 1993 provides that council rates and levied charges with respect to land constitute a charge over that land. S 550(2) then provides that

> The charge ranks on an equal footing with a charge on the land under any other Act but takes priority over any other charge or encumbrance.

S 550(4), however, states:

> The charge does not affect a bona fide purchaser for value who made due enquiry at the time of purchase but had no notice of the liability. A purchaser who has obtained a certificate under section 603 is taken to have made due enquiry.

A mortgagee would presumably come within the meaning of "purchaser" in this context. As, however, it would likely be difficult for a mortgagee to demonstrate "due enquiry" without obtaining (or sighting) a current certificate under s 603, this exception does little more than preventing a council claiming priority for rates and levied charges not disclosed in its certificate under that section.

R. Crown liens

As a result of the cumulative effect of Acts of Henry VIII, Elizabeth I and George III, the Crown acquired the right to charge any debt due to the Crown over any land that the debtor owned. This charge was somewhat inaptly known as a "Crown lien".

In New South Wales, Crown liens may still be claimed by the Crown, but s 189 of the Conveyancing Act makes registration a condition precedent to the operation of the lien.

The Crown need not rely on a Crown lien if it has a more specific statutory basis for its claim, having a charged created by a more contemporary statute such as the Land Tax Management Act 1956.