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Citation for published version:

Steven, A & Massaro, D 2008, 'Standard Securities and Variations to the Standard Conditions' Scots Law Times, pp. (News) 271.

Link:

[Link to publication record in Edinburgh Research Explorer](#)

Document Version:

Author final version (often known as postprint)

Published In:

Scots Law Times

Publisher Rights Statement:

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Standard Securities and Variations to the Standard Conditions

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The authors consider the standard variations made to standard securities by lenders and argue that there are difficulties with current practice.

One of the inevitable effects of the “credit crunch” and now the economic downturn has been more lenders enforcing securities because debtors have defaulted on loans. In October 2008 the Financial Services Authority reported that the number of “mortgage repossessions” in the United Kingdom in the second quarter of the year was up 71% from the same quarter in 2007. The Council of Mortgage Lenders has predicted that by the end of the year 45,000 homes will be “repossessed” compared with 27,100 last year. See <http://news.bbc.co.uk/1/hi/business/7694819.stm>. For lenders, the increased likelihood of having to enforce a mortgage, or rather in Scotland a standard security, makes it essential that the relevant documentation is coherent. This matters for borrowers too, as they need to understand their rights and obligations. There appear, however, to be difficulties with the documentation typically being used at present.

Background

The Conveyancing and Feudal Reform (Scotland) Act 1970, which regulates standard securities, is nearly forty years old. The legislation was of course the brainchild of the late Professor Jack Halliday. He chaired a committee which produced a report entitled *Conveyancing Legislation and Practice* (Cmnd 3118, 1966). This proposed many significant conveyancing reforms. Arguably the most important one actually implemented was the introduction of the standard security. It replaced the existing forms of heritable security. One of the features of these tended to be long documentation. The Halliday Committee was of the opinion that it would be advantageous to reduce this. Paragraph 121 of its Report states: “We consider that it would be practicable, after consultation with the parties principally concerned, to adjust a form of Statutory Security and to prescribe by statute standard conditions with regard to those matters which would be of general application and acceptable to both lenders and borrowers.”

The proposal in relation to “standard conditions” was implemented by Schedule 3 to the 1970 Act. It has a list of twelve such conditions. These regulate matters such as maintaining, repairing and insuring the property, the granting of leases over it and the procedures which the creditor must follow when enforcing the security. In terms of the 1970 Act section 11(2), the standard conditions are automatically incorporated into every standard security. There is power under section 11(3) of the Act for the parties to vary most of the standard conditions, but not those on the procedure for redemption and on enforcement of the security by sale or foreclosure.

Varying the standard conditions: general

The freedom of the parties to vary most of the standard conditions is justifiable for several reasons: particular transactions may have particular features; the law or practice of lenders may move on or individual lenders may have unique policies and requirements. What approach in general, however, should be taken? Here is Professor Halliday in his *The Conveyancing and Feudal Reform (Scotland) Act 1970* (2nd edn, 1977) para 8-01: “The effect of the legislation is that in all standard securities there is incorporated, without the necessity of expressing it in any detail, a built-in code governing the obligations, rights and remedies of the parties on certain matters which normally require to be regulated in a transaction effecting a heritable security.” It may be taken from this that typically there should be little need to vary the standard conditions.

Drafting suggestions from Professor Halliday

Professor Halliday was well known for his pragmatism. (He famously finished a letter published at 1984 SLT (News) 190 with the following: “If I may quote a relevant testimonial from one of my Glasgow clients of many years ago: “Judges are no’ daft”.”) He appreciated that lenders would depart from the standard conditions and therefore offered drafting suggestions at para 8-14 of his aforementioned book. These are reproduced in his *Conveyancing Law and Practice* (2nd edn, by I J S Talman), vol 2 (1997) para 53-12 and include:

“(2) Minor changes of wording of the standard conditions, unless they are of significant value, should be avoided. The standard conditions are familiar to

practitioners, and it will simplify practice if they are adopted unchanged in circumstances where they are reasonably adequate.

(3) If a standard condition, or a paragraph of it, is being changed, it will save the reader the task of referring to two documents if the whole condition or paragraph, as altered, is reproduced in the document affecting the variation, followed by a statement that the standard condition or its paragraph will not apply. The interpolation of different words or phrases by way of amendment of the standard condition is a less desirable method.

...

(5) Where substantial additions to or alterations of the standard conditions are required, as in the case of building societies where there are special rules and repayment conditions to be incorporated, the document should be arranged broadly so as to deal first with the special features affecting the debt and thereafter with the conditions which relate to the security”.

To these suggestions, we shall return later.

Current practice

Sheriff Cusine and Professor Rennie in chapter 4 of their *Standard Securities* (2nd edn, 2002) set out the practice of lenders in relation to variation of the standard conditions. This is normally to produce long variation documents which are issued to borrowers and often called “Mortgage Conditions”. In 1999 those authors commissioned a research assistant to review the documentation produced by 20 or so well known lenders and to highlight the extent to which the standard conditions are varied. The result is a helpful table which is reproduced as Appendix 3 to Sheriff Cusine and Professor Rennie’s book.

What are the reasons for the current practice? We would suggest three and there are probably others. The first is a general trend towards longer documentation. This has been seen in missives, commercial leases, construction contracts and in many other areas. The second is copying from other lenders. Again, this is a phenomenon which has happened elsewhere, missives being the obvious example. The third reason is copying from English documentation. Most high street lenders have English and Scottish “Mortgage Conditions” and it is difficult not to believe that the former have influenced the latter. In particular, there

is no English equivalent of the standard conditions, which means that English Mortgage Conditions are likely to be longer.

It would be wrong to suggest that the length of the documentation has significantly increased in recent years. There is a building society style reproduced at para 8-34 of Professor Halliday's *The Conveyancing and Feudal Reform (Scotland) Act 1970* which runs to 12 clauses over eight pages. At para 53-28 of his *Conveyancing Law and Practice* is to be found the Alliance and Leicester's then style, which runs to 23 clauses over 18 pages. Nevertheless, it is nearly ten years since Sheriff Cusine and Professor Rennie's survey and we felt that there might be value in carrying out a similar exercise. In the last few months, we have examined the documentation of 20 well known lenders. We found many similar things to those identified in the survey of Sheriff Cusine and Professor Rennie. In addition, there seem to be difficulties with some of the documentation. It is to these that we now turn. Before doing so, we would stress our own experience that drafting is an inherently challenging art. The criticisms which we offer are meant to be entirely constructive. It is also worth saying that we found helpful features in current documentation. For example, one lender has short summaries of each clause in its Mortgage Conditions, in order to assist the borrower.

Difficulty (1): minor changes of wording

As we saw above, Professor Halliday cautioned against minor changes of wording. It is not very hard to find examples of this advice not being followed. For example, standard condition one requires the debtor "to maintain the security subjects in good and sufficient repair to the reasonable satisfaction of the creditor". One lender has a condition requiring the debtor to "keep the property in good repair". The effect of this variation may be to impose an objective standard rather than what is to the creditor's "reasonable satisfaction". But why omit the word "sufficient"?

Standard condition two includes a requirement "not to demolish, alter or add to any buildings". One lender in its conditions stipulates "You must not alter or extend the property". Does this mean that demolition is therefore permissible because it has been omitted?

A further example relates to standard condition three. It requires the debtor to "observe any condition or perform any obligation in respect of the security subjects". This can be

interpreted as differentiating between obeying any prohibitions, such as negative real burdens (“observe any condition”) and fulfilling any positive obligations, such as affirmative real burdens (“perform any obligation”). One lender, however, simply requires the debtor to “keep to any title conditions”. This might suffice to cover title conditions, both positive and negative, but it does not quite match the duality of standard condition three.

One might wonder what the effect of such small differences between the standard conditions and the variations is. The difficulty is that Mortgage Conditions are in fact documents of variation and cannot be considered without comparing them to the standard conditions. As difficult as it may be, it is one of the principles of statutory interpretation that each word in a statute should be attributed meaning where possible: see F A R Bennion, *Bennion on Statutory Interpretation: A Code* (5th edn, 2008) 1157-1160. Considering then standard condition one, that of “good and sufficient repair” (mentioned above), both “good” and “sufficient” should therefore be read as imposing separate obligations on the debtor. By omitting one of those terms so as to impose an obligation of “good repair” only, as in the variation above, the lender is surely imposing a lesser standard on the debtor. This means that two sets of Mortgage Conditions produced by lenders in almost identical terms, one for Scotland and one for England, could be interpreted differently because the English document would be construed in isolation whereas the Scottish document would be construed by comparing it with the standard conditions. This highlights the second difficulty of current practice, to which we now turn.

Difficulty (2): having to refer to two documents

We quoted above Professor Halliday’s advice that if a standard condition is altered it is desirable to set out the replacement provision with a statement beside it that the equivalent standard condition, or part thereof, is not to apply. This advice is almost universally not being followed. The most significant difficulty with current practice is trying to read between a particular lender’s Mortgage Conditions and the standard conditions, and trying to work out the extent to which the latter have not been disapplied. We have had great difficulty doing it and we fear that a court would too. As for the non legally trained borrower it must be an almost impossible task, even where a lender has the standard conditions helpfully contained in the same document as an appendix. But the documentation of a number of lenders does not have such an appendix. Indeed, we have seen Mortgage Conditions which make no reference to the standard conditions whatsoever. We wonder if the reason for this is that English

conditions have simply been adapted to apply to Scotland, but without the existence and application of the standard conditions being fully appreciated.

A particular difficulty here is working out what an omission means. For example, many lenders do not have an equivalent to standard condition 1(c), which requires necessary repairs to be made to the security subjects and defects remedied “within such reasonable period as the creditor may require by notice in writing”. Most however do vary or re-state conditions 1(a) and 1(b). Does this mean that they do not intend condition 1(c) to apply, or are they simply relying on the fact it is in the standard conditions and therefore they do not have to state it expressly? The answer is that each lender’s set of Mortgage Conditions has to be assessed on its own merits and a conclusion reached, but this is hardly an easy task.

Another potential pitfall relates to the interpretation section of Schedule 3 to the 1970 Act. Here “debtor” is defined carefully as usually meaning “proprietor” of the subjects, if the debtor is in fact not the proprietor. This deals with third party security. An example of this is Alison granting a standard security over her house to Bethany in respect of certain debts owed to Bethany by Charles. This type of arrangement is fairly common as *Smith v Bank of Scotland* 1997 SLT 1061 and its successor case law have shown. Mortgage Conditions, however, appear generally not to use the term “debtor”. They employ alternatives. “You” is a particularly common one, but “customer” and “borrower” are also to be found. These terms tend to be defined as the person(s) named in the standard security document as the “borrower”. The effect appears to be in the example above that Alison becomes a co-debtor on the loan, rather than simply having her heritable property act as security for that loan. So Bethany can raise an action for payment against Alison rather than directly enforcing the standard security. This difference matters particularly if Alison’s house is worth less than the debt. Bethany can proceed against her for the shortfall. If Alison was not liable on the loan itself she could not. When as at present there is higher likelihood of negative equity, Bethany may well want to pursue such an action for payment. It may well be that in such circumstances special documentation is used which departs from the usual Mortgage Conditions, but it does appear to us that there is scope for difficulty here. On the problems of the liability of a provider of third party security depending on what documentation is used, see also K G C Reid and G L Gretton, *Conveyancing 2005* (2006) 116-118.

More generally, there is the fact that the standard conditions and lender's Mortgage Conditions are not at one on the crucial terminology as to the parties to the security. Indeed this is true as to the grantee too. The standard conditions use "creditor". Mortgage Conditions use "we", "us" and "our" or "bank" or "society" (as in building society). This inconsistency is undesirable. More specifically, some definitions do not work. Thus one lender's Mortgage Conditions provides that "'you" and "your" refers to each person named as the Borrower in the standard security . . . and includes (a) his executors or personal representatives; and (b) any person to whom title to the property passes. Each of you is responsible for the full amount owed if there is more than one of you." Despite this wording, a subsequent owner of the property could never be liable on the loan unless he or she specifically agrees.

Difficulty (3): not keeping the standard conditions separate from the loan conditions

As we also saw earlier, Professor Halliday recommended that Mortgage Conditions should separate clauses relating to the loan contract, a matter not covered by standard conditions, from those clauses which actually vary the standard conditions and relate therefore to the security rather than the debt. The point is that the loan conditions stand on their own and do not need to be read in conjunction with the standard conditions. Again there are many examples of this advice not being heeded. Thus one lender has a clause containing "[t]he borrower's obligations". The sub-clauses which follow include the duty to make monthly repayments, the duty to pay any other sums owed, the duty to indemnify the lender from any claims or proceedings under the Planning Acts and the duty to maintain the subjects of the security.

Difficulty (4): out of date conditions

Lenders will periodically review and update their Mortgage Conditions to reflect changes in the law. Sometimes, however, developments have been missed. One major lender's conditions, which were updated earlier this year, require the borrower to "pay on demand . . . all existing and future feu duties, ground burdens, rates, taxes . . . now or at any time payable in respect of the property". The feudal system was swept away on 28 November 2004 and any remaining feu duties with it. Assuming that "ground burdens" means ground annuals, they also disappeared on that date. Of course this same criticism could be made of the standard conditions which have not been amended by subsequent legislation when they probably should have been.

Difficulty (5): provisions which are challenging to understand

As Mortgage Conditions are issued to borrowers, who in most cases are not lawyers, it is desirable that they are written in language which is easy to follow. We mentioned earlier the fact that drafting is difficult. Nevertheless, there is in our view scope for greater clarity here. For example, one lender provides: “You will not do any of the following without first getting our written agreement: convey, transfer, assign, mortgage or grant security over . . . the property”. We do not know what the difference between “transfer” and “convey” is. Another lender states that ““Your House” shall mean the heritable or leasehold land . . . more particularly described in the Home Loan Security”. What, however, does “heritable land” actually mean?

Here is one more example from yet another lender: “In this condition “Ancillary Rights” means money which . . . is or becomes payable in respect of the Property or any damage to or depreciation of it and the benefit of any other obligation, security right or indemnity affecting or concerning the Property . . . You assign to us and hold in trust for us all Ancillary Rights.” We find this very difficult to understand and we have doubts as to its effectiveness. How can a right be assigned but at the same time held in trust? There is moreover a limit to the extent to which future rights can be assigned. See G L Gretton, “The Assignment of Rights” 1993 JR 23. Further, there is also the problem of specificity. How specifically must a right be identified before it can be assigned? See further R G Anderson, *Assignment* (2008) para 10.19-10.21.

Difficulty (6): provisions using English terminology

We noted earlier our impression that Scottish documentation had been influenced by practice south of the border. One of our reasons for drawing this conclusion was our discovery of English terminology in the Mortgage Conditions of some lenders. In fact an example is the clause quoted above which includes an instruction to the debtor not to “mortgage or grant security over . . . the property” without the lender’s consent. Another is the following: “We may at any time . . . transfer to any other person the benefit of all or any part of the Whole Debt, the Mortgage, any related security and all or any legal or equitable rights under any of the same.” Legal and equitable rights are well known concepts of English and not Scots law. A third example is the following which lists possible circumstances under which the debtor is in default: “if any diligence, execution, distress, sequestration, adjudication or other process

is levied or enforced upon any part of the property.” Both distress and levying execution are English procedures.

Statutory parallels

Some of the difficulties outlined are more serious than others. The last one, occasionally slipping into English terminology, is a relatively minor one. But others, in particular the necessity of having to read between two documents and wording which is difficult to understand are more serious. Before suggesting possible solutions, it is worth considering a couple of statutory parallels to Schedule 3 to the 1970 Act.

The first is relatively recent. It is the Tenement Management Scheme (“TMS”), to be found in Schedule 1 to the Tenements (Scotland) Act 2004. This came into force on 28 November 2004 and the idea is to provide a default system for management of all tenements. By section 4 of the 2004 Act, the TMS is subject to real burdens in the titles to tenements on the matters which it covers. So for example, a two thirds majority may be required to take decisions in terms of the titles. This would prevail over the simply majority requirement of the TMS. The flat owners of course are free at any time to register a new deed of conditions which further displaces the rules of TMS or indeed embraces them.

In advising on the drafting of deeds of conditions for new tenements, Professors Gretton and Reid have suggested using the TMS as the basis and amending and supplementing it where desired. See G L Gretton and K G C Reid, *Conveyancing* (3rd edn, 2004) para 27.09. If instead a conventional deed of conditions is used there is the need to refer to two documents. It is unclear as to what extent this advice is being followed.

The second example is older. It is Table A, the default set of articles of association for companies limited by shares. This is currently to be found in the Companies (Tables A to F) Regulations 1985, SI 1985 No 805. Now that the Companies Act 2006 is being brought into force stage by stage, Table A is to be replaced by The Companies (Model Articles) Regulations, a draft of which is to be found on the website of the Department for Business, Enterprise and Regulatory Reform: <http://www.berr.gov.uk/files/file45533.doc>. The final version is due to come into force on 1 October 2009. Having seen examples of actual company articles in order to consider their relationship with Table A, we found that parts of Table A were

expressly excluded or amended. This eased the task of trying to read between the two documents, although it was still not always a straightforward one.

Possible solutions

There are a number of ways in which the difficulties highlighted in this article might be addressed. The first is simply for current documentation to be reviewed and Professor Halliday's suggestions reconsidered. As mentioned, we think that the task of reading between two documents is a serious demerit of current documentation. A way of addressing this might be for Mortgage Conditions to have an express provision disapplying the standard conditions entirely, except of course those relating to redemption and enforcement which the 1970 Act provides cannot be excluded. Thus in relation for example to maintenance and insurance of the property and the granting of leases, debtors would only have to look at the Mortgage Conditions. These would set out the relevant rules. Given the extensive wording on such matters in many lenders' Mortgage Conditions, we wonder if this in fact is their intention at present. An express statement disapplying the standard conditions would put the matter beyond doubt and help the debtor understand more clearly and fully his or her obligations.

Secondly, there have been moves in recent years to standardise missives for residential property purchases (see http://www.lawscot.org.uk/Members_Information/convey_essens/stdmissives/) as well as for commercial property transactions (see <http://www.psglegal.co.uk/>). There may well be scope for similar efforts to be made with regard to variations to the standard conditions, perhaps under the auspices of the Council of Mortgage Lenders (CML). Of course it is unlikely that every member of that group would be willing to sign up to the same set of variations. But one model might be the CML Handbook for use by conveyancers: <http://www.cml.org.uk/handbook/Overview.aspx>. It has a Part 1 which is of general application and a Part 2 which provides the requirements of specific lenders. In other words there might be the possibility of a set of general variations to which all the lenders in the group could subscribe. This in our view would be an improvement on the current position.

A third and more long term suggestion is for the 1970 Act itself to be reviewed. The Scottish Law Commission would be best placed to do this. There would be various possibilities. A modern set of standard conditions could be produced, with the hope that lenders would not wish to deviate from it too significantly. It might include many of the additional conditions

and amendments made to the standard conditions identified by Sheriff Cusine and Professor Rennie. But with the march of time it is likely that there would be more and more variation. A revised version of this suggestion would therefore be to follow the Companies Act model and have the standard conditions in secondary legislation, which could more easily be updated. A more radical proposal would be to abandon the standard conditions, except perhaps for those on redemption and enforcement. These exceptions could be reconstituted as general rules governing standard securities, like, for example, the duty to get the best price on sale contained in section 25 of the 1970 Act. The conditions would then be left to be fixed by lenders as is the case in other countries, although hopefully there would be some efforts towards standardisation along the lines suggested in the previous paragraph.

We do not have a settled opinion on the best way forward and we hope that others will offer their views. What we do believe is that there is room for improvement in this area and particularly in the current economic climate it is desirable that the issues which we have raised are given wider consideration.