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Return of deposits

In what circumstances will the courts order the return of a deposit? Mark Pawlowski reviews old and new case law



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A contract of sale will often call for the immediate payment of a specified sum by the buyer as a guarantee or security that the contract will be performed. Where the buyer defaults, forfeiture will be implied from the mere fact that the sum is stated to be paid as a 'deposit' (see *Wallis v Smith* [1882]). By contrast, as a general rule, the seller is bound to return money that constitutes a 'part payment' of the purchase price. Ultimately, it is a question of construction to determine into which category the sum payable falls and whether it is forfeitable (see *Howe v Smith* [1884]).

Law of penalties

Although there may be little or no practical distinction between a deposit and a penalty (particularly where the deposit has fallen due for payment under the contract but remains unpaid by the buyer), English courts have shown a marked reluctance to apply the rule relating to relief against penalties to deposits even in circumstances where the sum deposited is wholly out of proportion to the actual or probable loss accruing to the seller. In the leading case of *Wallis*, referred to above, Jessel MR said:

Where a deposit is to be forfeited for the breach of a number [of] stipulations, some of which may be trifling, some of which may be for the payment of money on a given day, in all those cases the Judges have held that [the rule relating to relief against penalties] does not apply, and that the bargain of the parties is to be carried out.

Similarly, in *Hinton v Sparkes* [1868], Bovill CJ said:

The numerous cases referred to as to the distinction between penalty and liquidated damages have in my judgment no application to a contract [involving the forfeiture of a deposit].

There is, however, some English authority to support the proposition that equity does have jurisdiction to grant positive relief (apart from a mere extension of time to pay) against forfeiture of a deposit in circumstances where the sum retained is out of all proportion to the damage sustained and where it would be unconscionable for the seller to retain the money (see, for example, *Brickles v Snell* [1916]; *Stockloser v Johnson* [1954]; *Campbell Discount Co Ltd v Bridge* [1962]; *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd* [1993]).

Section 49(2) of the Law of Property Act 1925

In the context of a contract for the sale of land, a seller's right at law to forfeit the purchaser's deposit is mitigated by s49(2) of the Law of Property Act 1925, which gives the court a wide discretionary power to order the repayment of any deposit 'if it thinks fit', dependent on a general consideration of the conduct of both parties (especially the purchaser), the gravity of the matters in question and the amount at stake (*Schindler v Pigault* [1975] and *Universal Corporation v Five Ways Properties Ltd* [1979]). Although the jurisdiction is statutory, nevertheless, its discretionary character has been held to be at least akin to equitable relief against forfeiture (see *Schindler* per Megarry J). The subsection provides:

Where the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit.

While any limitation or restriction on the scope of the court's discretion under s49(2) would appear to be inappropriate in view of the broad wording of the subsection itself, it is apparent that a

'There may be little or no practical distinction between a deposit and a penalty but English courts have shown a marked reluctance to apply the law of penalties to deposits.'

number of guidelines have emerged from case law as to the circumstances in which the discretion to relieve from forfeiture should be exercised in favour of a purchaser. The most recent guidance has come from the Court of Appeal in *Aribisala v St James' Homes (Grosvenor Dock) Ltd* [2008].

Previous caselaw

In *Cole v Rose* [1978] Mervyn Davies QC interpreted Megarry J's observations in *Schindler*, above, as meaning that proof of some special circumstances (suggesting that it was unfair or inequitable that the purchaser should lose their deposit) was necessary to bring a case within s49(2). However, this narrow view was not followed by Buckley LJ in *Universal Corporation*, who preferred the view of Megarry J to the effect that the court had an unqualified discretion under the subsection to order repayment of the deposit when this would represent the 'fairest course between the parties', subject only to the discretion being exercised judicially and with due regard to all the relevant circumstances, including the terms of the contract.

In *Dimsdale Developments v De Hann* [1983] the Court expressed some doubt about the appropriateness of applying the discretion to a defaulting purchaser in a case where the seller was entitled to specific performance of the contract. In the Court's view, s49(2) was plainly enacted to confer a discretion in cases where the seller was for some reason not entitled to specific performance, and where the purchaser was not entitled to rescission (see also, *Michael Richards Properties Ltd v Corporation of Wardens of St Saviour's Parish, Southwark* [1975]). In such cases, the purchaser could be liable for damages for breach of contract and would be unable to recover their deposit. The Court felt bound to adopt the view expressed by the Court of Appeal in *Universal Corporation* and held, on the facts, that the justice of the case required that repayment of the deposit should be ordered, but only on terms that the purchaser submitted to a reduction representing the seller's damages.

More recently, Arden LJ in *Omar v El-Wakil* [2001] considered that the notion of fairness (expressed by Buckley LJ in *Universal Corporation*, above) was 'context-specific'. In the context of a conveyancing transaction, in particular, it was common knowledge that, if a

purchaser fails to complete the contract, they are likely to lose their deposit and so it was important that there should be an element of certainty attaching to the consequences of paying a deposit. According to Arden LJ, therefore, the starting-point was that a deposit 'should not normally be ordered to be repaid'. In *Omar* the seller had not sought to prove that he had suffered any loss as a result of the breach of contract. Significantly, Arden LJ considered this to be irrelevant, relying on the principle that, where a purchaser could not themselves perform the contract, the circumstances had to be exceptional to make it appropriate for the court to exercise its discretion under s49(2).

Aribisala

The purchaser in *Aribisala* sought repayment of a 10% deposit (totalling £216,000) paid for the purchase of two leasehold properties (comprising a penthouse and studio) owned by the seller. The contracts of sale incorporated the *Standard Conditions of Sale* (4th ed), which provided, *inter alia*, that the seller was entitled to rescind the contracts and forfeit any deposit if the purchaser

Reference point

For further discussion of *Aribisala* and s49(2) see issues 204 (p2), 202 (p8) and 195 (p12) of *PLJ*.

failed to comply with a notice to complete the transaction. At the date of exchange, the purchaser had not received a firm mortgage offer and, at the date fixed for completion, his lender would only offer a reduced mortgage. He then attempted to obtain additional funding but the seller eventually rescinded the contracts and forfeited the deposits. The purchaser then tried to negotiate an extension of time and made new proposals for payment of the balance of the purchase price. These proposals were rejected. In the meantime, both properties increased in value. At the hearing, the purchaser argued that the discretion to order repayment of the deposit under s49(2) should be exercised in his favour primarily because:

- (1) it represented a significant proportion of his assets;

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CONVEYANCING

- (2) he was unfamiliar with English conveyancing practice;
- (3) he had made various attempts to obtain additional funding;
- (4) he had been willing to complete the sales; and
- (5) the seller had made a profit from his breach of contract on the resale of the properties.

Floyd J, however, was unsympathetic because:

- (1) The deposit was only 10% of the purchase price and (contrary to the purchaser's contention) was not a large proportion of his assets.
- (2) The purchaser was aware of English conveyancing practice in terms of its relevant aspects. In particular, he knew of the need to raise the necessary finance by the completion date or risk losing the deposit.
- (3) His application for additional funding was made after the completion date and the eventual offer of finance was made not to him personally but to one of his companies.
- (4) Although he had shown efforts to raise the balance of the purchase money, this was only after the deposit had become forfeited. In any event, the terms offered to the seller were not as good as it could expect to receive elsewhere.
- (5) Although the seller's profit on resale (amounting to £366,000) was a factor to be taken into account, it was not decisive and certainly not enough (by itself) to make the situation different from the ordinary case where a deposit was not refundable.

Further guidance in exercising discretion

The judgment of Floyd J provides further guidance on the factors that the court should consider when exercising its discretion to order repayment of a deposit under s49(2). In the first place, it is important for the court to consider how close the purchaser had got to actually performing the contract. In *Aribisala* itself, the purchaser was not able to complete the purchase until long after the

deposit had been forfeited under the terms of the contract. Moreover, the requisite funding did not actually materialise until well beyond the completion date. In addition, it was relevant to consider what alternatives had been proposed to the seller to complete the sale and how advantageous they would be compared with performance of the actual contract itself. Thus, it would be 'exceptional' (in the sense described by Arden LJ in *Omar*) for the deposit to be returned if the purchaser could not perform the contract or offer any sensible alternatives to performance. Unfortunately, in *Aribisala*, the only alternative arrangements offered by the purchaser comprised an offer of a loan from a Nigerian bank to one of his companies (and not to him personally) and not for the full amount of the purchase price outstanding.

The mere fact that the seller cannot point to any loss arising from the breach will not by itself amount to a sufficient ground for the return of the deposit. Similarly, an increase in the market value will not, on its own, amount to a sufficiently exceptional circumstance justifying repayment. However, according to Floyd J, the question of whether the seller had made a loss (or a profit) from the purchaser's breach could still be relevant in some circumstances – in this sense, overall economic impact on the seller remained a relevant factor under s49(2). Floyd J gave two examples from the case law. In *Tennaro Ltd v Majorarch Ltd* [2003] the Court took into account the

fact that the seller could have sold the property at a higher price than the market value at the contractual date of purchase. Significantly in that case, the purchaser himself had found a new purchaser (who was willing to pay more than the contract price) prior to the completion date. Similarly, in the earlier case of *Dimsdale*, referred to above, the Court was influenced in ordering the return of the deposit because the seller had resold at a substantially higher price than it would have received under the contract with the defaulting buyer. It is apparent, therefore, that much will turn on the facts of the individual case. Thus, by contrast, in *Midill (97pl) Ltd v Park Lane Estates Ltd & anr* [2008], in the absence of any special reasons, the seller was held entitled to keep the deposit despite the fact that he had resold the property to a third party for a higher price.

Conclusion

The starting point is that a deposit should not normally be ordered to be repaid under s49(2). It is evident that the circumstances must be exceptional to make it appropriate for the court to exercise its discretion under the subsection. The fact that the seller has not proved any loss as a result of the breach of contract cannot (by itself) justify the return of a deposit. Similarly, an increase in the market value of the property will not, on its own, justify repayment. Such factors must be weighed against the need for certainty and the fact that, in the ordinary case, the deposit is not refundable. ■

Aribisala v St James' Homes (Grosvenor Dock) Ltd
[2008] EWHC 456 (Ch)

Brickles v Snell
[1916] 2 AC 599

Campbell Discount Co Ltd v Bridge
[1962] AC 600

Cole v Rose
[1978] 3 All ER 1121

Dimsdale Developments v De Hann
(1983) 47 P&CR

Hinton v Sparkes
(1868) LR 3 CP 161

Howe v Smith
(1884) 27 Ch D 89

Michael Richards Properties Ltd v Corporation of Wardens of St Saviour's Parish, Southwark
[1975] 3 All ER 416

Midill (97pl) Ltd v Park Lane Estates Ltd & anr
[2008] EWHC 18 (Ch)

Omar v El-Wakil
[2001] EWCA Civ 1090

Schindler v Pigault
(1975) 30 P&CR 328

Stockloser v Johnson
[1954] 1 QB 476

Tennaro Ltd v Majorarch Ltd
[2003] EWHC 2601 (Ch)

Universal Corporation v Five Ways Properties Ltd
[1979] 1 All ER 552

Wallis v Smith
(1882) 21 Ch D 243

Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd
[1993] AC 573