

Buyer beware

Graeme Fraser and Adam Colenso explain the nature and timing of advice that residential property lawyers should provide to cohabitant buyers in light of Jones v Kernott and the SRA Code of Conduct 2011.



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'Jones v Kernott [2011] illustrates the serious problems that can arise when cohabitant purchasers do not enter into an adequate declaration of trust.'

Evolving social trends in England and Wales mean that growing numbers of people cohabit together without marrying or entering into a civil partnership. Where there is no recorded agreement how the beneficial interest is to be held, disputes may well occur where one party wishes to sell the property, but the other party wishes to remain in the family home until the children have grown up, or where one party wants to move out because of the emotional trauma of splitting up but wants to eliminate the risk that their equity in the property will remain indefinitely locked up.

The recent Supreme Court decision in *Jones v Kernott* [2011] illustrates the serious problems that can arise when cohabitant purchasers do not enter into an adequate declaration of trust setting out, among other things, how the beneficial interest is to be held.

Trust law principles in a domestic property context **Legal and equitable interests**

The owner of the legal estate in property is the person registered on the proprietorship register at the Land Registry, or as specified on the conveyance. The legal owner may also be the owner of all of the beneficial interest in the property. However, the legal and equitable rights of ownership will separate where the ownership of the beneficial interest differs from that of the legal ownership and a trust of the equitable interest in property arises in favour of the beneficiaries, who then have equitable rights. Where co-owners hold the beneficial interest as joint tenants, each does not have a specific share in the legal title but is entitled

to a whole undivided interest in the property. Under a tenancy in common, equitable shares in a property can be held in equal or unequal proportions.

Written agreement

In the case of *Goodman v Gallant* [1986] the court decided that if a transfer, conveyance or deed or declaration of trust expressly stated the proportions in which the property is held, in the absence of any subsequent alteration to that trust or representations that could give rise to an estoppel, such a declaration was determinative of the respective beneficial interests in it unless and until such document is rectified on the grounds of mistake, fraud or duress. In *Goodman*, this meant that even though the parties had contributed unequally (Mrs Goodman gave evidence that she considered herself to have contributed 75% to the acquisition of the property) to the purchase of the property, once they had made a declaration that they were joint tenants, the party who had contributed was left with 50% of the equity in the property in the future, even though Mrs Goodman had contributed three times as much as Mr Gallant to the acquisition.

The Land Registry form TR1 now requires parties acquiring property in joint names to state whether they hold the property beneficially as joint tenants, or tenants in common in equal shares, or on the terms of some other specified trust. However, it is not compulsory for this section to be completed and it cannot be assumed that in every purchase the cohabitee purchasers have entered into a clear and informed declaration of trust.

No agreement in writing and constructive trusts

Where the title documentation is inconclusive as to the terms of ownership and if there is no agreement in writing, property claims are dealt with by reference to property and trust law.

Issues arise where a cohabiting couple acquire a property, that is either conveyed into only one name or there is a dispute over the proportions in which the beneficial interest is to be divided. If the parties had a common intention that a property was to be jointly owned, a constructive trust will arise and the parties will both be beneficially entitled to share in the equity of the property.

The House of Lords decision in *Stack v Dowden* [2007] attempted to clarify constructive trusts, deciding that where a property was jointly owned, the starting point would be that the beneficial shares were held equally by the legal owners. The onus was on the party claiming otherwise to show that the beneficial interests were not held equally and this was only likely to be established in very unusual circumstances. In identifying the extent of a couple's interests in the property, the court's task was to try to determine the couple's shared intentions, actual, inferred or imputed, with regard to the property, in the light of their whole course of conduct in relation to it. Relevant factors to the court's analysis include:

- advice or discussions at the time of the transaction about what was then intended;
- the reasons why, and purpose for which, the home was acquired in joint names;
- how the purchase was financed;
- how the parties arranged their finances and paid the property's outgoings; and
- the nature of the parties' relationship, their individual personalities, and whether the home was needed for their children.

In *Laskar v Laskar* [2008], the Court of Appeal went on to clarify that the presumption of joint beneficial

ownership where domestic property is transferred into joint names can apply to personal relationships other than cohabiting couples, but does not apply to investment property.

Stack created a debate about the court's ability to 'impute' a common intention. Lord Neuberger explained the difference between imputation and inference in his dissenting judgment in *Stack*, as follows:

An imputed intention is one which is attributed to the parties, even though no such actual intention can be deduced from their actions and statements, and even though they had no such intention.

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Imputation involves concluding what the parties would have intended, whereas inference involves concluding what they did intend.

Jones v Kernott [2011]

The leading judgment by Lady Hale and Lord Walker in *Jones* sets out the applicable principles in a case where a family home is bought in the joint names of a cohabiting couple but without an express declaration of their beneficial interests:

- Where there is no express declaration of trust, in a non-business context, a constructive trust is appropriate for determining beneficial interests in a family home registered in joint names.
- The starting point is that joint owners are joint tenants in equal shares in both law and equity.
- This presumption can be displaced by evidence of a different common intention at the time of acquisition or at a later date.
- The parties' common intention is to be deduced objectively from their conduct.
- If it is clear that either:

(a) the parties did not intend that there should be an equal division of the beneficial interest at the outset, or;

(b) had changed their intention, but it is not possible to ascertain by direct evidence or by inference what their actual intention was as to the share in which they would own the property, then each is entitled to 'that share which the court considers fair having regard to the whole course of dealing between them in relation to the property' (as per Chadwick LJ in *Oxley v Hiscock* [2004]).

- Each case will turn on its own facts using *Stack* guidance, although 'there will continue to be many difficult cases in which the court has to reach a conclusion on sparse and conflicting evidence' (per Lord Collins in *Jones*).

Now that the concept of fairness has been partially imported into the arena of cohabitation disputes, we can expect cases testing the redefined margins of the law in years to come.

The following case study explains how the law may now be applied in practice.

Case study: part I

John and Amanda Smith instruct you on the purchase of their home in joint names for £350,000. Although they have been living together for five years, share the same surname, and refer to each other as husband and wife, they are not married. They need a bigger home because Amanda recently gave birth to twins. Amanda is investing £40,000 to pay the deposit and conveyancing costs from money given to her by her parents, who had intended the money to be used for John and Amanda's wedding which was called off as Amanda's pregnancy was unexpected. They have applied for an interest-only mortgage together which was based on their existing earnings, although Amanda is unsure whether she will go

back to work, but may take on part time work in the future. Amanda will use any money she earns to pay towards the children's expenses or for holidays. John is likely to fund the mortgage repayments for the foreseeable future and to pay Amanda a housekeeping allowance. The mortgage is on an interest-only basis for a period of 20 years. They have taken out a joint life insurance policy to protect the mortgage over their lives. The policy will pay out on maturity in 20 years' time, but also has an encashment value if it is surrendered early. The couple have opted to buy a property that requires improvement and John has set aside £25,000 to pay for a contractor's labour and materials, although he also

of interest – ie one of them will be receiving a higher proportion of equity in the property for each pound contributed.

If there is a conflict of interest then Outcomes 3.6 (where the parties have a substantially common interest) and 3.7 (where the parties are competing for the same objective) have to be considered and complied with if you are to continue to act. While practitioners should carefully consider both Outcomes, where a conveyancer is acting on the purchase of a home by cohabitants the requirements of Outcome 3.6 will probably in practice be the same as those for Outcome 3.7. Outcome 3.6 states that you can only act for both parties if:

happy at the time of the purchase, it is essential to provide clear advice and a full explanation of the differences between joint tenancies and tenancies in common. Written confirmation from the clients should be recorded on file.

You should also record on file their decision as to ownership. If the couple have given proper thought as to how the beneficial interest will be shared, ask them to provide written instructions, together with an explanation for any decision where the reasoning is not self-evident. This document can then be used as the basis for drafting any declaration of trust and as proof at a later date of the parties' intentions.

Living together agreements

At the same time, you should consider working with a specialist family lawyer who can advise on a living together agreement. John and Amanda may require separate legal advice, and need to provide full disclosure of their financial and other relevant circumstances. The agreement will be contractually binding, provided it is not contrary to public policy. The living together agreement can mirror any express declaration of trust prepared on the purchase, and cover future intentions as to property ownership, household contributions, funding for children, and financial provision in the event of unemployment and retirement. Additionally, wills and estate planning advice should be sought to cover the position on death, taking into account tax implications.

Case study: part 2

John has come to see you after splitting up from Amanda. They are unable to find a buyer for their home. The joint policy has been surrendered and John is using the whole of the proceeds to fund a replacement home. Amanda is proposing to take over all the mortgage repayments for their joint home. He wants to ensure that he retains a 50% beneficial interest in the property. What advice should you give and what procedures should you follow?

Relevant confidential information

If you acted on the unsuccessful attempt to sell the home, review the conflict of interest guidance set out above. Assuming that you have been asked to act for John, consider whether there is any conflict that

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intends to do much of the work himself at weekends, and at his own expense.

What advice should you give John and Amanda and what procedures should you follow at the time of the property purchase?

First advice: consider conflict

Firstly, you will need to identify and deal with any potential conflict of interest in compliance with Chapter 3 of the SRA Code of Conduct 2011 and its 'Outcomes'.

You need to establish how much Amanda and John are each contributing (both in terms of direct payments and indirect financial contributions such as commitments to undertake work at the property) and then consider the type of property ownership proposed.

If Amanda and John are contributing equally to the acquisition of the property and both are content for there to be an equal ownership of the beneficial interest then there should not be a conflict of interest in acting for both of them. If they are contributing amounts that do not reflect the shares of the equitable interest that will be due to each of them upon a sale of the property (whether that be the 50/50 joint tenancy proportions or the tenancy-in-common proportions as set out in a declaration of trust or, in the absence of such declaration, on a 50/50 basis) then there is likely to be a conflict

- (a) you have explained the relevant issues and risks to the clients and you have a reasonable belief that they understand those issues and risks;
- (b) all the clients have given informed consent in writing to you acting;
- (c) you are satisfied that it is reasonable for you to act for all the clients and that it is in their best interests; and
- (d) you are satisfied that the benefits to the clients of you doing so outweigh the risks;

If you cannot satisfy these requirements then you should advise both Amanda and John that the conflict means they ought to seek separate representation regarding the declaration of their interests in the property. If you proceed without following these conflict checks then you run the risk of being accused at a later date of breaching your duty of care by drawing up documentation which was not in the best interests of one or other of the parties for whom you acted.

Recording instructions on file

In all situations, including a scenario where Amanda and John appear perfectly

prevents you acting for him. Do you, as a result of any earlier work you undertook when John and Amanda were both your clients, hold any relevant confidential information relating to John that he does not already have that your duty to act in his best interests requires you to disclose to him. If so, then you cannot act for him in relation to this matter and should tell him to seek alternative legal representation.

If you are not conflicted from acting for John, you need to advise him how best he can try to preserve his interest in the property.

Avoiding pitfalls

In *Jones*, which had similar facts to this case study scenario, the Supreme Court decided that Mr Kernott's action after he left the home justified a finding that he had intended to crystallise his interest at that time so that he was not able to share in the increase in equity following his departure. This decision developed the concept of an 'ambulatory' constructive trust so that a couple's shares in a property can, where there is evidence of such change, be held to have altered over time.

To help John avoid the same situation, you should advise him to continue to pay the mortgage if he can. Provide Amanda or her solicitor with a clear written statement explaining that John's intention in respect of the parties' beneficial interests in the property remains unchanged from when the parties acquired the property. John should resist any change suggested by Amanda to change the terms of the mortgage repayment and he should remain a signatory on the mortgage. John should make regular enquiries about whether and when the property is being sold. John should have an active and ongoing involvement in the day-to-day running of the property (including payments towards maintenance costs) and remain informed of any major works planned. He should not leave himself open to criticism that he is failing to maintain the twins.

By taking these steps, John could demonstrate that his and Amanda's common intention about the terms on which their beneficial interests are held have not altered.

Potential for dispute

If there is no written agreement in place, John and Amanda may find themselves in a complex legal dispute after they split up, resulting in litigation. In many cases, proportionality drives a couple to settle before trial as the costs and risks of an uncertain outcome outweigh the benefits of litigation.

Avoiding disputes

An express declaration of trust and living together agreement would be conclusive and create certainty. The express declaration of trust could set out a formula to determine how much John and Amanda would receive on the sale of the property, or if one buys out the other, factoring in contributions by them and other family members, the costs of sale, and uplift in value since purchase. This could be mirrored in a living together agreement, which would also focus on the practical arrangements to be made on splitting up, so avoiding bitterness and acrimony during the emotional trauma of relationship breakdown. If John and Amanda did not have a living together agreement in place, a separation agreement can be drawn up when they split up. The property may then be settled in trust for Amanda and the children to occupy until the children have reached majority.

Constructive trusts have been confirmed by the Supreme Court in *Jones* as being the appropriate vehicle for determining a cohabiting couple's beneficial interests in the absence of a written agreement. It is unlikely that John will be able to successfully

Goodman v Gallant
[1985] EWCA Civ 15
Jones v Kernott
[2011] UKSC 53
Laskar v Laskar
[2008] EWCA Civ 347
Oxley v Hiscock
[2004] EWCA Civ 546
Stack v Dowden
[2007] UKHL 17

argue that by leaving the property so that Amanda lives there exclusively, she is liable for occupation rent that he can then offset against any financial responsibility he has for the children. Specialist family lawyers can help John and Amanda negotiate a private agreement regarding future financial provision including child maintenance for the twins, or use the Child Support Agency (CSA) if necessary.

Conclusion

Residential conveyancers should never underestimate the importance of providing careful and appropriately timed advice to cohabitant buyers. Research indicates, however, that only 15% of cohabiting couples are believed to have a written agreement in place about their share in property ownership. Unless the beneficial interests are clearly set out and understood, there is potential for costly and risky litigation. Conveyancers must also be alive to the prospect of a professional negligence claim if a cohabitee suffers a loss caused by incompetent legal advice on the purchase and subsequent sale of a property. ■

Cohabitation reform

Resolution (formerly known as the Solicitor's Family Law Association) campaigns to reform the law to reflect the way people are choosing to live their lives. Where a couple have lived together, sometimes for decades, and had children together, Resolution believes it should no longer be possible for one partner to walk away without taking responsibility for the other partner's welfare.

Until there is legislative reform, more work is needed to educate the public about the 'common law marriage' myth, namely the mistaken belief that cohabitees acquire the same rights as married couples after living together.

Discussion in November 2011 between Resolution and Jonathan Djanogly MP indicated the government's support for better public awareness. Resolution plans to work with the Ministry of Justice to develop content on cohabitation for the online information hub and helpline proposed in the final report of the Family Justice Review in November 2011 to help separated couples resolve issues outside court.