

CITY OF LONDON LAW SOCIETY LAND LAW COMMITTEE

PROTOCOL FOR DISCHARGING MORTGAGES OF COMMERCIAL PROPERTY

1. Introduction

This protocol has been prepared by a sub-group of the City of London Law Society Land Law Committee ("the Committee"), incorporating input from the Association of Property Lenders and the CLLS Financial Law Committee.

The Committee is aware that there are a number of different procedures in the City for dealing with the discharge of mortgages of commercial property and it is concerned that an undue amount of time can be spent in negotiating completion mechanics suitable for a transaction that is acceptable to the various parties. Unlike residential conveyancing, there is no Law Society endorsed code for completion that relates to commercial property.

Unlike the Law Society's Code for Completion by Post, which envisages that the Code will be adopted wholesale by solicitors, this protocol is intended to be a guide as to steps and procedures that solicitors (and their clients) might adopt and which the Committee regards as being appropriate and fair to all parties. It is for the parties to any transaction to decide on a case by case basis whether to apply the protocol, whether at all or with such variations as they might agree.

This protocol sets out procedure which the Committee considers appropriate in the most common situations, and also addresses an alternative scenario that reflects particular commercial circumstances and where the first procedure is not applicable.

Although principally designed for commercial transactions, the protocol may also be appropriate for high value residential transactions; although consideration should be given to the protocol's interaction with the Law Society's conveyancing quality scheme and the handbooks of the Council of Mortgage Lenders and Building Societies Association.

2. Scenario One - The Standard Transaction

This section describes a standard form of transaction which this protocol is designed to address. Where transactions have different features, then all or part of this protocol may be helpful.

The standard transaction is as follows:

- There is a property owned by the seller. Title to the property is registered at the Land Registry and is subject to a registered first legal mortgage in favour of the seller's bank. There are no other registered charges.

- It is proposed that the property will be sold to the buyer. On completion of the sale, the mortgage in favour of the seller's bank will be discharged out of the sale proceeds.
- The buyer is borrowing from the buyer's bank to assist with the purchase and, on completion, a new mortgage is to be granted to the buyer's bank.
- All four parties (the seller, the seller's bank, the buyer and the buyer's bank) are represented by different firms of solicitors. (The procedure is easily adapted if the seller's bank does not instruct separate solicitors).
- The sale contract requires the purchase price (or the balance of the purchase price if a deposit has been paid) to be paid to the seller's solicitors on completion.

The key issues this protocol will seek to address include:

- the transfer of the completion monies between the various parties;
- the release of title deeds including all occupational lease documentation and other appropriate documentation relating to the property from the seller to the buyer;
- the completion (electronically or in paper form) of a discharge and the manner of its release to the buyer or the Land Registry as appropriate;
- suggested forms of undertaking that might be appropriate between the different firms of solicitors.

In addition, the protocol takes into account the following features:

- It is usual for the buyer and the buyer's bank to require the seller's bank's DS1 (the Land Registry form to discharge a mortgage) to be available on completion or to be signed in advance and delivered legally on completion with the original to follow shortly afterwards.
- The seller's bank will not want to release control of the DS1 until it knows that the redemption monies are in a solicitors' client account and it (or its solicitors) has the benefit of an unequivocal undertaking to pay the monies to the seller's bank shortly after completion and within a specified time frame to enable the mortgage to be fully discharged.

It is recognised that from the point of view of any particular organisation (whether property owner/investor or financier) they are likely to appear at different times on different sides of the standard transaction. The Committee considers that it is not appropriate for any organisation to insist on something when it is on one side of the transaction that it would not accept on the other side – nor should its solicitors.

Finally, the standard transaction assumes that the seller's bank will produce a paper discharge (in form DS1) and if appropriate a deed of release which will release chattels, contracts, warranties and other assets which are part of the sale but not released by a DS1. These documents will be collectively referred to as the DS1. Electronic discharges are addressed separately below.

3. Prior to exchange of contracts

- The seller and the buyer should agree the extent to which the protocol will be used.
- The contract will require the seller to provide an executed DS1 on completion, and evidence of authority of the signatories if appropriate (before agreeing this, the seller will need to check the seller's bank's requirements).
- The seller and the buyer must agree the timing of completion. Completion at 2pm should give the seller's solicitors time to send monies on to the seller/seller's bank after completion and to achieve same day funds, but this may depend on whether the seller's bank insists on having the money at an earlier time, for example, to unwind interest rate hedging arrangements. It may be that the seller's bank requires completion earlier in the day, and the seller's solicitors may want to check this before exchange, but the Committee regards 2.00pm as the usual contractual requirement.

Appendix 1 contains suggested drafting for inclusion in the contract.

4. Before completion

- The DS1 shall be signed by the seller's bank and left undated and sent to the seller's solicitors or seller's bank's solicitors (held to the seller's bank's solicitors' order) with appropriate evidence of authority on the part of the seller's bank's signatories to sign (see paragraph 8 below).
- The seller's bank's redemption statement is to be provided to the seller and agreed, setting out what sum is required to complete on a particular day and whether there is a time cut off. If money is required early in the day because, for example, a swap needs to be unwound, it is not unusual for an extra day's interest to be added to the redemption monies to allow completion to take place after the cut-off time. Ideally the statement should include a daily rate. If appropriate, there may be a rebate to the seller after completion. It is recognised that the seller's bank may not be able to provide the statement until the morning of completion.
- Completion monies will be transferred to the seller's solicitors (held to the buyer's solicitors' order). This scenario assumes that all of the monies are transferred to the seller's solicitors and then dispersed by them after completion.
- The seller's solicitors have before completion undertaken to the seller's bank's solicitors or the seller's bank to transfer the agreed redemption figure to the seller's bank immediately after completion (or by a specified time if appropriate).

- The seller's solicitors have before completion undertaken to the buyer's solicitors to hold the completion monies to the buyer's solicitors' order.

Appendix 2 contains suggested forms of undertaking for the seller's solicitors to give to the seller's bank or seller's bank's solicitors and to the buyer's solicitors.

5. Completion telephone call

(This assumes completion by telephone. The same steps could be carried out at a meeting or at a combination of the two)

- The solicitors for all parties will be on the same call.
- The parties agree that once the steps have started all of the steps will be completed.
- The seller's bank's solicitors unconditionally release the DS1 and title deeds. (Reference to "title deeds" includes other documents relating to the property that are kept with the deeds).
- The buyer's solicitors unconditionally release funds to the seller's solicitors.
- The DS1, TR1 (transfer) and other transaction documents are completed in the usual way.
- The new mortgage is completed.
- The seller's solicitors undertake to send the completed DS1/TR1/title deeds to the buyer's solicitors. This could be a verbal undertaking made on the call, or a written undertaking issued in advance and effective from completion.
- The buyer's solicitors undertake to send the completed TR1 (etc.) to the seller's solicitors. The buyer's solicitors issue any agreed undertaking to the buyer's bank's solicitors.

6. After completion

- The seller's solicitors comply with their undertaking to send the redemption money to the seller's bank.
- The seller's solicitors comply with their undertaking to send the completion documents to the buyer's solicitors.
- The buyer's solicitors comply with their undertakings to the seller's solicitors and the buyer's bank's solicitors.

7. Scenario Two

Scenario One envisages that the completion monies will all be collected together by the buyer's solicitors and transferred to the seller's solicitors before completion and then dispersed by the seller's solicitors after completion. Although this is the preferred position,

it is sometimes not achievable, and the main reasons for this are either that the seller's bank insists on having completion monies in its own solicitors' client account before completion can take place, or, alternatively, that there is a concern as to whether the money will arrive with the seller's bank early enough for their internal redemption to take place. It is recognised that it may be an absolute requirement of the seller's bank that the money is with their own solicitors at the point of completion.

Scenario Two envisages split transfers with monies being held by the seller's solicitors and the seller's bank's solicitors.

This scenario is an alternative. The main reason for preferring Scenario One to Scenario Two is that Scenario Two requires information about the seller's banking arrangements, that may be sensitive, to be divulged to third parties.

Paragraphs 3 – 6 above are repeated but with the following changes:

- The seller's solicitors' completion statement requires the completion monies due on completion to be split so that part is sent to the seller's solicitors and part to the seller's bank's solicitors. Both sets of solicitors will undertake to hold the money to the buyer's solicitors' order.
- In this scenario, the DS1 will be held by the seller's bank's solicitors.
- At completion, the seller's bank's solicitors undertake to send the completed DS1 to the buyer's solicitors after completion (and a copy to the seller's solicitors).
- The buyer's solicitors unconditionally release funds to the seller's solicitors and to the seller's bank's solicitors.
- The monies due to the seller's bank will be sent not by the seller's solicitors but by the seller's bank's solicitors.
- After completion, the seller's bank's solicitors comply with their undertaking to send the completed DS1 to the buyer's solicitors (and a copy to the seller's solicitors).

Scenario Two does not work if the seller's bank is not instructing separate solicitors. Scenario One, however, is easily adapted to this circumstance.

The contract provision in Appendix 1 and the completion undertakings in Appendix 2 will need to be adapted for Scenario Two.

There are also occasional circumstances where the seller's bank may want to insist that the money (or that part of it required to discharge the mortgage) is held by the seller's bank itself at the point of completion. The Committee does not regard this as being a preferred approach and consider that it should only be necessary in very unusual circumstances. If

this is agreed by the buyer and the buyer's bank then alternative arrangements will need to be made.

8. Proper Execution of DS1

The Committee regards it as being the responsibility of the seller's bank to provide a DS1 that is either executed in a form that gives automatic protection to a purchaser (i.e. under Section 44 of the Companies Act 2006), or the executed DS1 is accompanied by evidence of an appropriate facility letter or other arrangement with the Land Registry or an up to date and properly executed power of attorney or a legal opinion (particularly in the case of an overseas bank) or other appropriate evidence that will be acceptable to the Land Registry to enable the DS1 to be registered. This should be made available at the same time that the DS1 is signed and handed over on or before completion.

If the seller's bank is not separately represented by a firm of solicitors, then the parties will need to consider what the seller will be required to provide to enable the buyer's solicitors to register the DS1 at the Land Registry. The seller's solicitors and the buyer's solicitors will need to agree what is to be provided.

Any requirements of the buyer in this respect should be reflected in the contract and should be reviewed where appropriate with the seller's bank and its solicitors in the light of the seller's bank's signing arrangements and requirements for redemptions generally.

9. Electronic Discharges

There are a small number of lenders who use electronic discharges (EDs). E-DS1s are generally not used on commercial property transactions. By the nature of an electronic discharge, there will be no physical DS1 handed over on completion, nor is it considered appropriate for the seller's bank's solicitors to give an undertaking relating to the discharge of the mortgage (as would be the case with residential conveyancing). In this case, it should be explained to the buyer and the buyer's solicitors that there is a risk that the electronic discharge will not be issued after completion and appropriate confirmation should be obtained directly from the seller's bank (given by somebody with appropriate authority) that the seller's bank will arrange for the electronic discharge to be issued to the Land Registry promptly following completion.

It is noted that even when there is an electronic discharge of the mortgage, it may still be necessary for there to be a deed of release, (as highlighted in the final paragraph of paragraph 2) and this should be dealt with as per Scenario One or Two as appropriate.

10. Professional Indemnity Insurance

Although by no means standard, it is not uncommon for a firm of solicitors that will be holding a large sum of money on completion to be asked to confirm whether it has appropriate professional indemnity insurance at a level to cover the amount. The Committee

has no view on whether this should be regarded as normal practice and regards it as a matter between the parties and their solicitors.

11. Proceeds Shortfall

In the current market, it is not unusual for the sales proceeds of a property to be less than the amount required to discharge the mortgage. It is the view of the Committee that it is appropriate for the seller to be asked to confirm whether the sale proceeds will be sufficient to discharge the mortgage. If they are not (or if confirmation is not given) it will be appropriate for the buyer's solicitors to request confirmation before exchange of contracts that the seller's bank has approved both the terms of the sale contract and the completion mechanics referred to and that completion may occur and its mortgage will be discharged (even though the sale proceeds may be insufficient to discharge the mortgage). Committee members have had recent experience of difficulty at completion where a mortgagee, that is not being repaid in full and has not been fully consulted on the details of the transaction, creates particular difficulties when it comes to completion mechanics.

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APPENDIX 1

DRAFT CONTRACT PROVISION

1. DISCHARGE OF CHARGES

1.1 This clause [] applies where a charge over the Property is to be discharged on completion and the person with the benefit of that charge (the "Lender") is to execute the Discharge.

1.2 On completion the Seller shall supply to the Buyer's Solicitors an executed Discharge.

1.3 If the charge is registered at the Land Registry:

1.3.1 Where the Lender is represented by a conveyancer (which in this clause [] has the meaning set out in Rule 217A Land Registration Rules 2003), the Seller shall procure that, on or before the Completion Date, the Seller's Solicitors provide the Buyer's Solicitors with written details of the name, address and reference of the conveyancer acting on behalf of the Lender or written confirmation that the Seller's Solicitors are acting as the Lender's conveyancer; and

[1.3.2 Where the Lender is not represented by a conveyancer (as defined above), the Seller shall procure that at the same time as the Seller sends the executed Discharge to the Buyer's Solicitors, the Seller also sends to the Buyer's Solicitors a duly completed Form DS2 signed by [either] [the Seller's Solicitors] [or] [the Lender], to enable the Buyer's Solicitors to register the Discharge at HM Land Registry.]

["Discharge" means the DS1/DS3/deed of release as appropriate]

N.B.1 In clause 1.2, the parties should consider whether it is appropriate to include a requirement that evidence of proper execution (as referred to in paragraph 8) is provided. Similarly clause 1.3.2 may not be appropriate in every case.

N.B.2 This drafting does not apply to electronic discharges.

N.B.3 If a DS3 will be delivered on completion then 1.3.2 should be amended either to require the Seller to deliver a duly completed Form AP1 (rather than a DS2) to allow its registration or for it to provide sufficient information for the Buyer's Solicitors to be able to confirm the identity of the unrepresented Lender.

APPENDIX 2

DRAFT COMPLETION UNDERTAKINGS

1. Undertaking given by Seller's Solicitors to Seller's Bank (or Seller's Bank's Solicitors)

This Undertaking relates to the sale of [] (the "Property") and the discharge of the registered charge over the Property (together the "Transaction"). [We confirm that you have authorised us to collect the Redemption Monies (defined below) on completion of the sale on your behalf.] We confirm that [we are holding] [on receipt we will hold] the signed DS1 [and deed of release (together)] (the "DS1") [and the title deeds, as per Schedule 1] to your order. This is on the basis that we can complete the DS1 and hand it over unconditionally to the [buyer or the buyer's solicitors] [with the title deeds] on completion of the Transaction, but subject to the undertaking set out below.

We undertake as follows.

- (i) We will not complete the Transaction unless we are holding in our client account at [bank] a sufficient sum to pay the amount (the "Redemption Monies") set out in the redemption statement in Schedule 2 (the "Redemption Statement").
- (ii) Following completion of the Transaction we will [by the time specified in the Redemption Statement] [by [] pm] on [date] give instructions to [bank] to transfer the Redemption Monies to your¹ account as set out in the Redemption Statement.

SCHEDULE 1 – Title Deeds

SCHEDULE 2 – Redemption Statement

2. Undertaking given by the Seller's Solicitors to the Buyer's Solicitors and (if appropriate) the Buyer's Bank's Solicitors.

This Undertaking relates to the sale of [] (the "Property") and the discharge of the registered charge over the Property (together the "Transaction").

¹ This will need amending if the account is not that of the recipient of the undertaking.

- (i) We confirm that we are holding the Release Documents as set out in Schedule 1 signed by [] (the "Bank") and the Transaction Documents as set out in Schedule 2 signed by the seller and the title deeds listed in Schedule 3.
- (ii) On receipt from the buyer's solicitors of the amount (the "Completion Amount") set out in the Completion Statement in Schedule 4 we will hold the Completion Amount strictly to the order of the buyer's solicitors until completion of the Transaction.

[Alternative to number (ii)]

On receipt from the buyer's solicitors of the sum of £[] [the first tranche] and from the buyer's bank's solicitors of the sum of £[] [the second tranche], together in aggregate the Completion Amount as set out in the Completion Statement in Schedule 4, we will hold the first tranche strictly to the order of the buyer's solicitors and the second tranche strictly to the order of the buyer's bank's solicitors until completion of the Transaction.

- (iii) Unless the Transaction has already completed, we will on your instructions return [the Completion Amount to the buyer's solicitors] [the first tranche to the buyer's solicitors and the second tranche to the buyer's bank's solicitors] as soon as possible within banking hours on that day or as soon as practicable thereafter.
- [(iv) We confirm that we have the authority of the seller [and the Bank] to receive the Completion Amount on completion.]
- (v) We confirm that the Completion Amount (together if appropriate with other monies we already hold in our client account) is sufficient to redeem the existing charge in favour of the Bank (as advised by the [Bank]) and that we are authorised by the Bank to complete the Release Documents on completion of the Transaction.
- (vi) Following completion of the Transaction we shall send to the [buyer's solicitors/buyer's bank's solicitors] the Release Documents and the Transaction Documents by courier or DX. Where documents are sent by courier we shall not be responsible for any delay or failure to deliver by the courier provided that the courier instructed is a reputable and responsible company. Where documents are sent by DX we shall not be responsible for any failure in the DX system provided that we deliver them to the [DX depot].
- [(vii) *If the discharge is electronic* We will notify the buyer's solicitors and the buyer's bank's solicitors as soon as confirmation is received from the Bank that the discharge has taken or is taking place.]

SCHEDULE 1 – Release Documents

SCHEDULE 2 – Transaction Documents

SCHEDULE 3 – Title Deeds

SCHEDULE 4 – Completion Statement

N.B. If the discharge is electronic, in addition to the inclusion of paragraph (vii), amendment will need to be made in relation to the reference to "Release Documents" in the undertaking.