DEPOSIT ACCOUNT FINANCING: SECURITY INTERESTS OVER A BANK'S OWN INDEBTEDNESS*

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I. THE CHARGE-BACK[1] DEBATE REVIVED

The remarkable growth in the financial sector of the economy in the last two decades has given rise to a transformation of financial services generally. The banking community, with the advent of a deregulated sector industry and the resulting heightened competition, has extended the range of facilities available to customers. Endeavouring to maintain customers' accounts, banks have increasingly sought to provide a one-stop financial service centre for their customers.

Although the functions of banks have expanded dramatically in recent times, their main business is associated with the lending and borrowing of money. A bank will regularly require that money advanced to a borrower be secured by the borrower's assets. With nearly $35 billion held by financial institutions in New Zealand in various demand, savings, and time deposit accounts in June 1991,[2] it is not surprising that the borrower's credit, represented by the balance of the deposit account with the bank, has proved to be a popular form of collateral.[3] Australia, Canada, England, and the United States of America have all had the same experience.[4]

The decision of Millett J in *Re Charge Card Services Ltd*,[5] however, has caused concern in banking communities.[6] That concern relates to the finding

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1 Charges over a customer's deposit account granted to his bank as security for an advance will be referred to as charge-backs throughout the course of this paper. Charges include legal and equitable mortgages as well as equitable charges.

2 Reserve Bank, *Reserve Bank Weekly Statistical Release*, August 1991. This figure represents a net funding amount, with reduction of amounts held by the institutions on behalf of another financial institution.

3 See the comments of R Dugan, "Subordination Agreements, Loan Participations and Deposit Account Financing Under the Draft Personal Property Securities Act", unpublished seminar presented to the Study Group on Business Finance, (Institute for Taxation and Business Law), 1 May 1991, Wellington.

4 Australia; C Y Lee, "Set-Off in Modern Banking", a chapter from G Burton (ed), *Directions in Finance Law*, Butterworths, Sydney, (1990), p 82.
Canada; W G Bellack-Viner, "Security over Bank Deposits: The Aftermath of *Re Charge Card Services Ltd*" (1990) 6 BFLR 82.
England; P J Cresswell et al, *Encyclopaedia of Banking Law*, Butterworths, London, looseleaf service up to 1990, ¶ E2486; and *Review Committee on Banking Services Law, (Jack Report), Banking Services: Law and Practice*, HMSO, London, (1989, Cmnd 622), ¶ 14.20.
United States; see for example comments in *Gillman v Chase Manhattan Bank, N.A.* 534 NE 2d 824, 830 (CANY, 1988). See also generally A C Harrell, "Security Interests in Deposit Accounts: A Unique Relationship Between the UCC and Other Law" 23 UCCLJ 153, 175 (1990), and D L Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection - The Common Law is Alive and Well" [1989-90] 39 Drake L Rev 259.

5 [1986] 3 All ER 289; [1987] Ch 150; [1986] 3 WLR 697; [1987] BCLC 17.

6 See the comments R Baxt, "Banker and Customer - Whether a charge can be taken by bank over customer's account - Effect of mutual dealings", (1987) 61 ALJ 662, 664; and comments of Richard Youard at the Fourth Annual Conference of the Banking Law Association (7 - 8 May

by the judge that it was impossible for a debtor to grant a charge to a creditor over the creditor's own indebtedness to the debtor.[7] Put another way, the creditor could not use the debt owed to him by the debtor as collateral for an advance of credit to the debtor. The implication for a bank is that it is not possible to be granted a charge over a customer's deposit account as collateral for the extension of an overdraft or loan facility to the same customer.[8] The decision does not affect the right of a third party to be granted a charge in the customer's deposit account with a bank.[9] But what *Charge Card Services* and a trilogy of Australian cases[10] have done is to create an illogical barrier to banks being granted a security interest in such a common and obvious asset of a customer. It is absurd that this should be the end result.[11]

This paper revisits the charge-back authorities. Analysis reveals that Charge Card Services and the supporting authorities do not have a sound foundation. Rather there are no compelling reasons to doubt the legitimacy of charge-backs. With the reform of personal securities law well in progress in New Zealand, the writer notes that the draft Personal Properties Securities Act[12] does little to improve the present unsatisfactory state of this aspect of deposit account financing.[13] As will be argued, this is a serious omission and should be remedied.[14]

II. The Nature of Deposit Accounts

1 *The banker-Customer relationship and the deposit account*

The relationship between the banker and its customer is generally that of debtor and creditor.[15] The legal title or ownership to the money deposited into the customer's account passes to the banker upon the deposit and "he is known to deal with it as his own".[16] The deposited money loses its identity. There is no longer any specific fund held by the banker on behalf of the depositor.[17] So what legal right does the depositor have over the deposit? Barwick CJ in *Croton v R*[18] stated the depositor's right in these terms:[19]

1987, Manly, NSW), recorded in *Banking Law and Practice*, Prospect Publishing, Woolloomooloo, 1987, pp 168-169.

7 [1986] 3 All ER 289, 308.

8 Rather than using the terms debtor and creditor, banker and customer will be used to denote the parties whom the transactions explained below will affect. The use of their descriptions as creditor and debtor is made confusing because in the type of the transaction which is considered throughout this paper the creditor will also be a debtor of the debtor. For example, the bank will be a creditor in respect of the money advanced to the customer, but will be a debtor in respect of the deposit by the customer at the bank.

9 [1986] 3 All ER 289, 309.

10 *MPS Construction Pty Ltd (in liq) v The Rural Bank of New South Wales* (1980) 4 ACLR 835; *Broad v Commissioner of Stamp Duties*, [1980] 2 NSWLR 40; and *Estates Planning Associates (Aust) Pty Ltd v Commissioner of Stamp Duties* (1985) 2 NSWLR 495.

11 See the comments of R Turner, "Broad's Case and Set-Offs", from *Banking Law and Practice 1986*, Prospect Publishing, Woolloomooloo, NSW, 1986, p 68.

12 The draft Act is contained in New Zealand Law Commission's report, *A Personal Property Securities Act for New Zealand (Report No 8)*, Government Printing Office, Wellington, 1989.

13 See pp 398 et seq.

14 See pp 403-404.

15 *Foley v Hill* (1848) 2 HL Cas 28, 35; 9 ER 1002, 1005 (per Lord Lyndhurst LC): and 44; or 1008 (per Lord Brougham). See also *Bank of Marin v. England*, 385 US 99, 101 (1966); 17 L ed 2d 197, 200. The relationship may not always be that of creditor and debtor: under certain circumstances the banker may become (i) a bailor; (ii) a trustee; or (iii) an agent - see generally F E Perry, *Law and Practice Relating to Banking*, 4 ed, Methuen, London, (1983), p 9.

16 *Foley v Hill* (1848) 2 HL Cas 28, 35.

17 See P J Cresswell et al, *Encyclopaedia of Banking Law*, ¶ E2486.

18 (1967) 117 CLR 326; (1967) 41 ALJR 289.

19 Ibid, at 330, 291.

[T]hough in a popular sense it may be said that a depositor with a bank has 'money in the bank', in law he has but a chose in action, a right to recover from the bank the balance standing to his credit in account with the bank at the date of his demand, or the commencement of action. That recovery will be effected by an action for debt. But the money deposited becomes an asset of the bank which may use it as it pleases: see generally Nussbaum, *Money in the Law*: s 8, p 103.

The result is that the depositor loses title to the funds upon deposit but he retains the incorporeal bundle of rights enforceable by action for debt in the common law courts - the chose in action.[20] The customer has a debt which is owed by the bank. The debt is the depositor's personal property.[21]

Likewise, the customer who maintains a debit balance at the bank will generally be a debtor and the bank a creditor. Therefore, where the customer maintains both a deposit account and an overdrawn cheque account he is both a creditor and a debtor of the bank.

2. *What is the subject of a charge-back?*

It is convenient at this stage to emphasis what is actually being charged to the bank under a charge-back. The customer of course has no right to grant a security interest in property which is not rightfully his under the *nemo dat quod non habet* rule.[22] While a charge-back is often referred to as a charge over the moneys held in the deposit account, this is not possible so long as the creditor-debtor relationship exists, as the customer has already passed good title to the moneys to the bank.[23] What is charged to the bank is the debt owed to the customer. It is the only property in the fund that the customer is left with.[24] Therefore the non-possessory security interest is in the customer's right to withdraw the funds from the deposit account.

3. *Liens and pledges - what property do they attach to?*

Unlike charge-backs, both liens and pledges are possessory security interests. A lien involves the retention of the customer's property, while a pledge "cannot be given without the delivery of the possession of the goods" by the pledgor, the customer in the context dealt with here.[25] Therefore the essential distinction between a lien and a pledge is that one arises quite independently of the parties intention by operation of law or equity, while the other is dependent on the customer intentionally giving possession of property on security. But both involve the bank holding the property of the customer as security for an advance to the customer. It is here that it becomes obvious that the subject of the security interest is completely different from that involved when a non-possessory security interest is taken over a deposit account. Possessory rights in security cannot use as collateral the chose in action, even where it is a third party who is providing the collateral for an advance to a customer of the bank. There is simply nothing upon which a lien or pledge can attach. This is unquestionable, at least in respect of a lien, since Lord Denning MR's and Buckley LJ's comments in *Halesowen Presswork & Assemblies v Westmin-*

20 See the comments of D I Everett, "Security over bank deposits", [1988] A Bus L Rev 351, 352.

21 *Alcom Ltd v Republic of Columbia and Santos (First National Bank of Boston and Barclays Bank plc, garnishees)* [1984] 2 All ER 6 (HL) where it was held that "property" in the State Immunity Act 1978 (UK) also included the debt owed to a customer by its bank.

22 Briefly stated the rule provides that no person can pass better title to property than that which he possesses.

23 *Foley v Hill* (1848) 2 HL Cas 28, 35.

24 *Croton v R* (1967) 117 CLR 326, 330. See also *Royal Trust Co v Molsons Bank* (1912) 27 OLR 441, 444 (per Falconbridge CJ).

25 *Ayers v South Australian Banking Co* (1871) LT 3 PC 548, 554 (per Mellish LJ).

ster Bank.[26] What also clearly emerges from that case is the acceptance that a lien can arise in respect of "all securities deposited with [the bank] by a customer".[27] Notwithstanding the distinction as to the intention of the parties, this statement must equally apply in respect of a pledge. In any event, it has been held that it is possible for a pledge to be given in respect of a negotiable instrument.[28]

III. The Prohibition of Charge-backs

1. *Introduction*

Within the Commonwealth, up until the decision in *Charge Card Services*, the banking practice of obtaining a charge-back over a customer's deposit account, in the event of extending loan facilities to that customer, had been widely utilized as a form of deposit account financing. This practice had been the subject of a great deal of comment.[29] Remarkably there had been only two Australian cases which dealt with the issue directly,[30] and one indirectly.[31] The two Australian authorities directly on point and *Charge Card Services* have all held that such collateralization was not possible. Each of the judges in these cases had sought to rationalize their views on the basis of the obiter comments of Buckley LJ in *Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd.*[32]

The *Charge Card Services* case has itself rekindled the controversy. The case has encouraged wide comment by scholars and practitioners as to the efficacy of charge-backs.[33]

26 See pp 377-379 and especially nn 38-48 and accompanying text.

27 [1970] 3 All ER 473, 487-488. This comment of Buckley LJ was derived from the oft-cited banking case of *Brandao v Barnett* (1846) 3 CB 519, 531; 136 ER 207, 212; [1843-60] All ER Rep 719, 722 (per Lord Campbell).

28 See for example *Carter v Blake* (1877) 4 Ch D 605; and *Harrold v Plenty* [1901] 2 Ch 314.

29 See for example R M Goode, *Legal Problems of Credit and Security*, Sweet & Maxwell, London, 1982, p 86, where he stated that it was not possible to create a charge-back; and for an opposing view see W J L Blair, "Charges over Cash Deposits" (1983) IFL Rev 14, 16.

30 *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40; and *Estates Planning Associates (Aust) Pty Ltd v Commissioner of Stamp Duties* (1985) 2 NSWLR 495.

31 *MPS Construction Pty Ltd (in liq) v The Rural Bank of New South Wales* (1980) 4 ACLR 835.

32 [1970] 3 All ER 473, 487-488.

33 See for instance: R M Goode, *Legal Problems of Credit and Security*, 2 ed,, p 124; E P Ellinger, *Modern Banking Law*, Oxford University Press, Oxford, 1987, p 598; Weaver and Craigie, *Banker and Customer in Australia*, 2 ed, ¶ 20.850; J King, "*Broad's Case* and Set-Offs", from *Banking Law and Practice 1986*, Prospect Publishing, Woolloomooloo, NSW, 1986, pp 51-52; T Shea, "Credit Cards - Retention Clause - Contingent Debts", [1986] 3 JIBL 192, 196; D I Everett, "Security over Bank Deposits" [1988] A Bus L Rev 351, 364; D Pollard, "Credit Balances as Security - I", [1988] J Bus L 127, 137-138.
For those who challenge *Charge Card Services* see: M Hapgood, *Paget's Law of Banking*, 10 ed, Butterworths, London, 1989, p 526; P J Cresswell et al, *Encyclopaedia of Banking Law*, ¶ E2486; P R Wood, *English and International Set-Off*, Sweet & Maxwell, London, 1989, ¶ 5-134 et seq; R Turner, "Broad's Case and Set-Offs", from *Banking Law and Practice 1986*, pp 63-67; G Forster, "Ways and Means of Taking Security Over Bank Deposits", from *Banking Law and Practice 1985*, Longman Professional, Sydney, 1985, pp 114-115; R Calnan, "Securing Cash Deposits in England", (1989) JIBFL 297, 300; R Baxt, (1987) 61 ALJ 662, 664; and W G Bellack-Viner, "Security over Bank Deposits: The Aftermath of *Re Charge Card Services Ltd*", (1990) 6 BFLR 82. And from an American standpoint arguing in favour of the legitimacy of charge-backs see D L Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection - The Common Law is Alive and Well", [1989-90] 39 Drake L Rev 259.

2. *Halesowen Presswork v Westminster Bank revisited*

Halesowen is something of the seminal case in this line of authorities. The obiter dicta particularly of Buckley LJ and, to a lesser extext, of Lord Denning MR, have been taken as supporting the view that a debtor is unable to grant to a creditor a security interest over the creditor's own indebtedness to the debtor, the charge-back.

The facts begin in February 1968 with Halesowen Presswork & Assemblies ("HPA") having an overdrawn account ("No 1 account") with National Westminster Bank ("the bank") to the extent of £11,339. The bank, concerned with the state of this account, initiated consultations. It was agreed that the bank would freeze the No 1 account and that a No 2 account would be opened through which all the current business of HPA would pass. The No 2 account was always to remain in credit. In June 1968 HPA deposited a cheque for £8,611 in its No 2 account and on the same day at a creditors' meeting with HPA the company resolved to be voluntarily wound up. The cheque was credited to the No 2 account the following day and cleared the day thereafter. In the liquidation the bank claimed that the agreement to keep the accounts separate came to an end on liquidation and it was entitled to exercise a banker's lien on the £8,611, or, at any rate, combine the account with the amount owing by HPA under the No 1 account. The liquidator contested this claim and alleged that the credit balance of the No 2 account should be applied for the benefit of the general creditors.

Diplock J held that there was an agreement between the bank and HPA that the bank would not be entitled to exercise any right of set-off so long as the banker-customer relationship continued. The judge found that HPA's resolution of voluntary winding up determined the relationship and allowed the bank to exercise its rights of statutory set-off under Section 31 of the Bankruptcy Act 1914 (UK).[34]

The liquidator appealed on the grounds that the bank had not taken any steps to determine the agreement to separate the accounts, and that therefore it was not entitled to combine the accounts. By a majority, Buckley LJ dissenting, the Court of Appeal upheld the appeal on the grounds that HPA had done nothing to "unfreeze" the No 1 account. The agreement therefore continued over the liquidation of HPA preventing the bank from combining the accounts or setting-off one against the other. Furthermore, the bank was not entitled to exercise its rights of statutory set-off under the Section 31 of the Bankruptcy Act 1914 (UK)[35] because there was no mutuality of debts.[36]

A further appeal by the bank to the House of Lords was successful. Their Lordships, Lord Cross dissenting, held that the right of statutory set-off could not be contracted out of. The provision was mandatory. Further the Court considered that on the facts the debit on the No 1 account and the credit on

34 *Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd* [1970] 2 WLR 754, 775; [1970] 1 All ER 33 (QBD).

35 See now s 323 of the Insolvency Act 1986 (UK).
The right to set-off mutual debts in the event of one party's insolvency is also provided for in legislation in Australia (s 86 of the Bankruptcy Act 1966 (Cth)), and New Zealand (s 93 of the Insolvency Act 1967). Mutual dealing requires that the debts must be between the *same parties* and in the *same right*. See for a detailed discussion of statutory set-off W S Weerasooria, *Banking Law and the Financial System in Australia*, 2 ed, Butterworths, Sydney, 1988, §§ 20.01 et seq; R Derham, Set-Off, Oxford University Press, New York, 1987; and P J Cresswell et al, *Encyclopaedia of Banking Law*, ¶¶ E2474-E2480.

36 *Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd* [1970] 3 All ER 473, 479 (per Lord Denning MR); 486 (per Winn LJ).

the No 2 account amounted to mutual dealings within Section 31 of the Bankruptcy Act 1914 (UK).[37]

As stated, it is the obiter remarks of Buckley LJ in respect of the banker's lien issue that have been found to have greatest impact in the charge-back analysis. The judge stated:[38]

> When that cheque was cleared it ceased to be a negotiable instrument and also ceased to be in the possession of the bank. Any lien of the bank on the cheque must thereupon have come to an end. The amount of the cheque was credited to the No 2 account on the 13th June 1968. The money or credit which the bank obtained as the result of clearing the cheque became the property of the bank, not the property of the plaintiffs [HPA]. *No man can have a lien on his own property*, and consequently no lien can have arisen affecting that money or that credit. The amount of the credit of the plaintiffs on the No 2 account was, of course, increased, but this credit represented indebtedness by the bank to the plaintiffs as its customer, and *I cannot myself understand how it could be said with any kind of accuracy that the bank had a lien on its own indebtedness* to the plaintiffs. It has, of course, long been recognized that a banker has a general lien on all securities deposited with him as banker by a customer unless there be an express contract or circumstances that show an implied contract inconsistent with lien: see *Brandao v Barnett* [(1846) 3 CB 519, 531, [1843-60] All ER Rep 719, 722], per Lord Campbell. The term 'securities' is no doubt used here in a wide sense, but does not, in my judgment, extend to the banker's own indebtedness to the customer.
> Where the relationship of the banker and customer is a single relationship such as I have already mentioned, albeit embodied in a number of accounts, the situation is not, in my judgment, a situation of lien at all. *A lien postulates property of the debtor in the possession or under the control of the creditor.* [Emphasis added]

It is clear that the judge found that a lien could not attach on either the money in the account or the increase in the credit balance on the No 2 account. Buckley LJ's comments were expressly approved of by Viscount Dilhorne and Lord Cross on appeal.[39] Lord Cross stated:[40]

> In the judgments below the question is raised whether the rights which the bank claims to exercise can be properly described as an aspect of the 'banker's lien'. No doubt the bank acquired a 'lien' on the cheque drawn by Messrs Girling on their bankers. But that cheque was duly honoured and any lien which the bank had on the piece of paper and the obligation of Messrs Girling created by their drawing the cheque was soon replaced by an increase in the bank's indebtedness to the company. *I agree with Lord Denning MR and Buckley LJ that a debtor cannot sensibly be said to have a lien on his own indebtedness to his creditor. It may be that as a matter of history the recognition by the courts of the right of a banker to treat several accounts as one was influenced by their earlier recognition that in the absence of agreement to the contrary a banker had a lien on all securities in his hands for the general balance owing to him on all accounts. But to describe the right to consolidate several accounts as an example of the banker's lien is, I think, a misuse of language.* [Emphasis added]

Some of the earlier cases had shown some misunderstanding as to the extent of the banker's lien.[41] There had been some confusion between the banker's lien, the right to set-off and the right to combine accounts.[42] However, as is firmly established by *Halesowen*, a banker's lien is a general possessory lien over all securities belonging to the customer held by the bank for securing its balance on all accounts.[43] A lien cannot apply to intangible personal property such as a debt. On the facts of *Halesowen* no lien arose. Logically this is correct. The banking transaction which occurred can be followed through

37 *Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] 1 All ER 641, 649 (per Viscount Dilhorne); 652 (per Lord Simon); 663-664 (per Lord Kilbrandon).

38 [1970] 3 All ER 473, 487-488.

39 [1972] 1 All ER 641, 646 (per Viscount Dilhorne); and 653 (per Lord Cross).

40 Ibid, at 653.

41 For example *Misa v Currie* (1876) 1 App Cas 554.

42 See for instance the comments of L A Sheridan, *Rights in Security*, Collins, London, 1974, pp 213-214.

43 See also, for an earlier expression, the comments of Lord Inglis in *Robertson's Trustee v Royal Bank of Scotland* (1890) 18 R 12, 16.

carefully to illustrate the point. Without doubt the bank had a banker's lien on the cheque as it was presented for payment to the account of HPA.[44] However, the cheque as a negotiable instrument[45] was discharged upon it being cleared by the payor's bank.[46] The cheque was, upon payment, worthless and in the possession of the payor's bank. The money transferred to the account by the cheque became the property of the bank upon deposit and was not capable of being the subject of a lien because no one can have a lien over their own property, in much the same way that no one can grant a lease to himself over land which he owns.[47] In any event the funds in the account were not represented by actual cash at the bank, but rather by a debt owed to HPA.[48] Therefore the only possible property which could be the subject of the lien was HPA's right in respect of the money, the debt owed to HPA by the bank in the No 2 account. But this was not possible because a lien can only attach to something tangible; it is a possessary security device.

3. *MPS Construction Pty Ltd (in liq) v The Rural Bank*[49]

The decision in *MPS Construction v Rural Bank* is not direct authority for the proposition that a bank cannot be granted a charge over its own indebtedness. Like *Halesowen*, the case involved issues relating to banker's lien and set-off.

MPS Construction ("MPS") had an overdraft account with the Rural Bank ("the bank"). To provide security towards the bank's advances under the overdraft account, MPS and the bank entered into an agreement headed "Equitable Mortgage", in which it was stipulated that the bank "shall have a lien on all monies, bills of exchange, promissory notes that belong to [MPS] and which have been or may now or shall hereafter be deposited". Meanwhile, as a term of a building contract between MPS and the Council of Willoughby ("the Council") a retention fund had been established and was held at the bank in the joint names of MPS and the Council. Those moneys were held on trust by the Council for the benefit of the company. MPS went into liquidation owing $13,120 under the overdrawn account. The liquidator claimed the money in the retention fund at the bank. However, the bank claimed to be entitled to set-off the two accounts or to claim the moneys under the Equitable Mortgage.

Helsham CJ held that the security document called "Equitable Mortgage" was intended to create the banker's general lien under the law merchant. He said in respect of the document:[50]

> But this one includes in the lien moneys as well as documents. One can easily understand a lien over a customer's documents held by a bank, but what is meant by a lien by a bank over money is not so easy to grasp.

44 This was recognized in *Halesowen* [1970] 3 All ER 473, 477 (per Lord Denning MR); 484 (per Winn LJ); 487 (per Buckley LJ); and in the House of Lords on appeal [1972] 1 All ER 641, 646 (per Viscount Dilhorne); and 653 (per Lord Cross).

45 Cheques were negotiable at common law (*Grant v Vaughan* (1764) 3 Burr 1516; 97 ER 957) and this was codified in New Zealand under s 8 of the Bills of Exchange Act 1908.

46 Section 59(1) of the Bills of Exchange Act 1882 (UK); and see the New Zealand equivalent in s 59(1) of the Bills of Exchange Act 1908.

47 *Rye v Rye* [1962] 1 All ER 146, 150 (per Viscount Simonds); 155 (per Lord Denning). See also p 384 below.

48 See pp 374-375.

49 (1980) 4 ACLR 835.

50 Ibid, at 840.

The judge was content that no lien could exist for the reasons given in the Court of Appeal in *Halesowen Presswork & Assemblies v Westminster Bank*.[51] There was simply no property of MPS which was capable of being subject to a lien as a lien could not apply to moneys held in a deposit account.[52] The bank further argued that the chose in action of MPS, in respect of the debt owed by the bank to it, could be and was charged. However it was held that the security document could not be given that construction. The only property of MPS charged was that in respect of which the bank had a lien.[53] Unfortunately for the bank, the judge held that through want of mutuality no right of statutory set-off arose: the two debts were not owed by and to the same parties.[54]

4. *Broad v Commissioner of Stamp Duties*[55]

Broad's case involved a depositor purportedly granting a security interest to the bank over his deposit account as collateral for an advance by the depositary bank. The primary issue revolved around whether the executed agreement titled "Security over Deposits with 'own' or 'other' Bank", constituted a mortgage or charge under the Stamp Duties Act 1920 (NSW).

Lee J, in the Supreme Court (Administrative Law Division) of New South Wales, was of the view that an assignment of the depositor's account was impossible as "such an assignment could only operate as a release of the debt, or a covenant not to sue".[56] The judge therefore interpreted the assignment, albeit conditional, as transferring ownership to the bank of the property, the debt, and therefore cancelling the debt under the law of merger. Additionally, there was a transfer of the right to sue, which would have been wholly dependent upon the bank suing itself. As there could be no assignment, so there could be no mortgage, legal or equitable. In respect of the actual transaction he said:[57]

> The very fact that "the deposit" means no more than an indebtedness of the bank to the plaintiff in the sum of $4,000 makes it impossible, in my view, for it to be held that the instrument is a mortgage or charge, on the simple footing that there can be no mortgage or charge in favour of oneself of one's own indebtedness to another.

The judge was of the view that the point had been expressly dealt with by Buckley LJ's comments in *Halesowen Presswork & Assemblies v Westminster Bank* that a bank cannot have a lien over its own indebtedness. Lee J concluded that the agreement gave no more to the bank than the right to set-off its own indebtedness against the indebtedness of the depositor at any given time. And:[58]

> Such a contractual right to set off, even if considered to be a "security" in the wide sense of that word, cannot be regarded as a mortgage or charge.

51 See pp 377-379.
52 (1980) 4 ACLR 835, 841.
53 Ibid, at 842.
54 Ibid, at 845. See n 35 for brief explanation on mutual dealings under statutory set-off.
55 [1980] 2 NSWLR 40.
56 Ibid, at 46.
57 Ibid.
58 Ibid, at 48.

5. *Estates Planning Associates (Aust) Pty Ltd v Commissioner of Stamp Duties*[59]

Estates Planning Associates ("EPA") operated an Employees Retirement Fund for the benefit of their employees. Part of that Fund included a superannuation policy with APA Life Assurance Ltd ("APA"). EPA, as the policy owner, granted a security interest to APA as collateral for a loan. The relevant terms of the loan agreement were as follows:

> We, the policy owner, hereby *release the above policy as collateral security* to [APA] in consideration of the payment of the total amount of loan specified to the borrower on the conditions set out below.
> 4.From any sum payable under the policy specified, [APA] *may retain the total amount of loan secured by the policy*, together with any unpaid interest.
> 5.If at any time during the continuance of this agreement the total amount owing to [APA] by way of this loan and any other loan which may have been granted and interest thereon shall exceed the then surrender value of the policy the policy shall thereupon become absolutely void. [Emphasis added]

The Commissioner of Stamp Duties assessed $305.80 as stamp duty on the loan agreement on the grounds that the agreement constituted a mortgage for the purposes of Section 3(1) of the Stamp Duties Act 1920 (NSW). There was an appeal by way of case stated to the New South Wales Supreme Court questioning whether the loan agreement did create a mortgage under the Act. The Commissioner sought to distinguish *Broad v Commissioner of Stamp Duties*[60] on the basis that there the case involved a debtor and creditor relationship, while in this case the policy so "mortgaged" did not constitute a present debt but a right to have the policy moneys paid to the owner of the policy when the necessary conditions were fulfilled, or upon surrender.

Yeldham J refused to distinguish *Broad's* case in such a manner. The judge held that the policy conferred present rights upon EPA as well as a contingent right to receive the endowment sum. The loan agreement attempted to assign to APA the EPA's rights to the "debt" constituted by the policy, or the rights of EPA were released to the extent necessary to satisfy the loan. The judge was content, after liberal reference but no analysis, to rely on the reasoning of Lee J in *Broad's* case. *Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd* was also referred to, but without analysis. The judge said:[61]

> In my opinion, the proper construction of the "loan agreement" document in the setting to which it was signed is that there is assigned pro tanto to APA the rights of the plaintiff in the chose of action constituted by the policy, or else that any such rights are released by the plaintiff to the extent necessary to satisfy any indebtedness of the latter to APA. *There is not, in my view, any property over which a security by way of mortgage or charge has been or could be given.* The provisions of pars 4 and 5 of the document are repugnant to the notion of a mortgage as set out in *Broad's* case even if, as [counsel for the Commissioner] argued, the document does not in reality constitute a release. [Emphasis added]

But the effect of the loan agreement, the judge said, was to:[62]

> ... relieve APA from the obligation, which it would otherwise have, to make payment under the policy to the extent and in the event that, when such policy matures or is surrendered, moneys lent by APA to [EPA] are still outstanding, or else to render such policy void in the event that the circumstances envisaged by cl. 4 of the document occur. It does not operate as an assignment or transfer of property and hence is not a mortgage.

59 (1985) 2 NSWLR 495.
60 [1980] 2 NSWLR 40.
61 (1985) 2 NSWLR 495, 500.
62 Ibid.

In the end, therefore, APA could not be granted the mortgage or charge because there was no property which was capable of being charged, and the result was that all APA had was a right of set-off. The judge, as stated, relied on *Broad's* case. The reasoning of Lee J in that case is not based on whether there is property which is capable of being charged, but rather on the basis that a person cannot have a lien over his own indebtedness. In a way Yeldham J was taking a round-about way of saying the same thing in stating that there was no property capable of being charged, but only because of the peculiar nature of the conception that a person cannot be granted a charge over his own indebtedness. But it is incorrect to state that the debt owed to EPA was not chargeable to any other person.[63]

6. *Re Charge Card Services Ltd*[64]

Charge Card Services Ltd ("CCS") operated a credit card scheme for cardholders and participating service stations, in which petrol and other merchandise could be purchased on credit. There were effectively two agreements entered into. The first, between CCS and the service station, authorized the service station to sell select merchandise on credit to a cardholder. The service station would forward a completed sales voucher to CCS, and the latter was obliged to pay to the service station the face value of the sales voucher less a commission. The second agreement, between the CCS and the cardholder, provided that the company would forward a monthly statement of the transactions entered into by the cardholder in the previous month, as recorded by the sales vouchers, and the balance owing was to paid by the cardholder to CCS. The agreements anticipated that payments would be made to the service stations in respect of credit card sales and this would occur before recovery of the money owing to CCS from the cardholders in respect of the same sale. To finance its operations CCS entered into a factoring agreement with Commercial Credit Services Ltd ("Commercial Credit"). That agreement provided that all present and future debts owed by cardholders to CCS were to be assigned to Commercial Credit in return for a sum equal to those receivables less a discount. Commercial Credit was also entitled to retain any amount in its absolute discretion "as security for" (i) any claims against CCS; (ii) any risk of non-payment by any cardholder;[65] and (iii) any amount that was chargeable by Commercial Credit to CCS. CCS agreed to guarantee the payment by every cardholder and could be required by Commercial Credit to repurchase any receivable in stated events. CCS became insolvent and eventually a liquidator was appointed. A considerable amount was owing to creditors. Commercial Credit had not issued a demand for the repurchase of the receivables due from the cardholders, therefore at the time there was a large sum outstanding from the cardholders. There was also a considerable sum retained by Commercial Credit under the terms of the agreement. The liquidator contended, *inter alia*, that the retention of moneys payable to CCS was expressly reserved by Commercial Credit as security for its prospective rights of set-off, and that in consequence it constituted a charge on book debts which was void for want of registration against the liquidator and CCS's creditors.[66]

63 See for instance the comments of Millett J in *Re Charge Card Services Ltd* [1986] 3 All ER 289, 308.

64 [1986] 3 All ER 289.

65 As a matter of practice the factor retained 15 percent of receivables against risk of bad debts, and 85 percent of receivables over four months outstanding.

66 Under s 95(1) of the Companies Act 1948 (UK) (now s 395 of the Companies Act 1985 (UK)),

A summary of Millett J's findings was given before his reasoning. The judge stated:[67]

> If the right of retention constitutes a charge, there is no doubt that it is a charge on book debts and is a charge created by the company. But is it a charge at all? The sum due from Commercial Credit to the company under the agreement is, of course, a book debt of the company which the company can charge to a third party. In my judgment, however, it cannot be charged in favour of Commercial Credit itself, for the simple reason that a charge in favour of a debtor of his own indebtedness to the chargor is conceptually impossible.

It had been conceded on behalf of the liquidator that it was simply not possible for a debt to be assigned to the debtor, since the agreement would amount to no more than a release of the debt in whole or part. And for this same reason a similar concession had been made with respect to the grant of a legal or equitable mortgage over the debt to the debtor, as such a security transaction has the effect of an assignment by way of security, operating as a conditional release. It would seem, given the judge's reasons for his decision, that he regarded these concessions as being well made.[68] But in regard to the grant of an equitable charge, it was argued that there is no conveyance or assignment of the property and therefore this ground for objection did not apply. Relying on the oft-quoted passages from *Palmer v Carey*[69] and *National Provincial and Union Bank of England v Charnley*,[70] Millett J held that the essence of an equitable charge was that specific property of the chargor was expressly or constructively appropriated to or made answerable for payment of a debt, and the chargee had the right to resort to the property for the purpose of having it realized and applied towards the payment of the debt. This was done without the conveyance or assignment to the chargee. And the effect of the availability of the equitable remedies gave the chargee a proprietary interest by way of security in the property charged.[71] The judge continued:[72]

> The objection to a charge in these circumstances is not to the process by which it is created, but to the result. A debt is a chose in action; it is a right to sue the debtor. This can be assigned or made available to a third party, but not to the debtor, who cannot sue himself. Once any assignment or appropriation to the debtor becomes unconditional, the debt is wholly or partially released. The debtor cannot, and does not need to, resort to the creditor's claim against him in order to obtain the benefit of the security; his own liability to the creditor is automatically discharged or reduced.

Support for this reasoning was taken from the obiter comments made by Buckley LJ in *Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd* that no man can have a lien on his own property, nor can a bank have a lien on its own indebtedness.[73] Millett J recognised the point that a lien could only attach to tangible property. He thought, however, that Buckley LJ's remarks were based on the identity of the parties rather than on the particular features of the security device.[74]

every charge is deemed void, so far as it relates to security, as against the liquidator and any creditor of the company unless it is registered within 21 days of its creation. See ss 102 and 103 of the Companies Act 1955 (NZ) which are substantively similar except that registration must be within 30 days.

67 [1986] 3 All ER 289, 308.
68 See below the reasons for Millett J's decision.
69 [1926] AC 703, 706-707.
70 [1924] 1 KB 431, 449-450.
71 [1986] 3 All ER 289, 309a-b.
72 Ibid, at 309c.
73 [1970] 3 All ER 473, 487. See pp 377-379.
74 [1986] 3 All ER 289, 309.

Millett J's finding that a charge-back was "conceptually impossible" was based essentially on three arguments. These arguments were:

(i) a debtor cannot sue himself;

(ii) a debt is automatically released upon default by customer; and

(iii) a lien cannot be created over a customer's credit balance at a bank.

The outcome of the case was, that while no equitable charge was held to exist, CCS was entitled to set off any mutual debts with Commercial Credit. The judge decided that a charge-back was conceptually impossible and stated:[75]

> It does not, of course, follow that an attempt to create an express mortgage or charge of a debt in favour of the debtor would be ineffective to create a security. Equity looks to the substance, not the form; and, while in my judgment this would not create a mortgage or charge, it would no doubt give a right of set-off which would be effective against the creditor's liquidator or trustee in bankruptcy, provided that it did not purport to go beyond what is permitted by s 31 of the [Bankruptcy Act 1914].

It appears, however, that the judge erred here. The contractual rights of set-off are terminated upon one of the parties' insolvency.[76] It is the statutory right of set-off which applies in such an insolvency; a statutory right of set-off for the mutual debts of two parties.[77] Since the judge refused to accept the charge-back argument advanced by the liquidator, it was in fact only the right of statutory set-off which applied to the benefit of Commercial Credit in this case.

Given the judge's bold statement of the illegitimacy of charge-backs, it is startling to note that it appears that this issue was not fully or properly argued before the judge.[78]

The case went on appeal to the Court of Appeal and was affirmed without any discussion on the charge-back point. Indeed the issue does not even appear to have been raised.[79]

7. *Professor Goode's approach*

Professor Goode was once of the opinion that a charge-back was possible.[80] However, he is now no longer of that view. Goode relies on three reasons for his present stance. First, the essence of an assignment of a debt is that the assignee will then become entitled to recover the debt, and can sue to recover. However where the assignee is also the debtor, the debtor cannot sue himself,[81] and therefore an assignment cannot occur - it transfers nothing.

His second argument is based on comments made by Lord Denning MR, Buckley LJ and Lord Cross in *Halesowen Presswork & Assemblies Ltd v.*

75 Ibid, at 309g.

76 See s 222 of the Companies Act 1955 (NZ) which renders void any disposition of property of the company, including things in action, that is made after the commencement of winding-up.

77 In light of House of Lords decisions in *British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758 and *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] 1 All ER 641, the statutory right of set-off is mandatory and may not be contracted out of. This may be put in doubt following the comments made by Richardson and Bisson JJ in *Attorney-General v McMillan & Lockwood Ltd (in rec & in liq)* (1990) 5 NZCLC 66743, 66750 (but in that case the issue related to contracting out of the *pari passu* rule: s 293 of the Companies Act 1955.

78 See the comments of R Youard in "Preferences - Running Accounts", from *Banking Law and Practice 1987*, (n 6), p 169.

79 [1988] 3 All ER 702 (CA).

80 He notes this in *Legal Problems of Credit and Security*, 2 ed, 1988, 124.

81 Goode relies on *Rye v Rye* [1962] 1 All ER 146, where it was held that a property owner cannot grant a lease to himself: See 150 (per Viscount Simonds); 155 (per Lord Denning).

Westminster Bank Ltd.[82] That case is authority for the proposition that a bank cannot have a lien over moneys held in a bank account and also that a bank cannot have a lien over its own indebtedness to a customer.[83] Goode argues that this must equally apply in cases of non-possessory security interests:[84]

> It is true that the comment was made in relation to a lien rather than a mortgage or charge. But the reason why it was said that the bank did not have a lien on the credit balance was that "a debtor cannot sensibly be said to have a lien on his own indebtedness to his creditor," and this must be equally true of non-possessory forms of security.

Thirdly, Goode argues that Section 136 of the Law of Property Act 1925[85] requires a statutory assignment to be absolute, in writing in the hand of the assignor (the customer) and must be notified in writing to the debtor (the bank). That provision, Goode states, clearly contemplates three parties: the assignor, the assignee, and the debtor.[86]

8. *Other commentators supporting Charge Card Services*[87]

The other commentators really advance no further reasons in respect of the grant of a mortgage to a bank over its own indebtedness. However there is an interesting "further objection" to the bank collaterizing its customer's deposit account by means of an equitable charge. Everett advances this argument:[88]

> As an equitable charge operates as a security device by reason only of the availability of equitable remedies to enforce the underlying contractual obligations [*National Provincial & Union Bank of England v Charnley* [1924] 1 KB 431, 449 (per Atkin LJ)], it is impossible to conceive of a court ordering that the chargor/creditor specifically perform his contractual obligation to hold the chose in action for the benefit of the chargee/debtor when it is already within the exclusive power of the debtor itself to repay the debt.

This ground for objection will be considered below.[89]

9. *Summary*

The legitimacy of charge-backs has been attacked on four grounds: (i) the bank cannot sue itself to enforce the debt; (ii) *Halesowen Presswork v Westminster Bank* has authoritatively laid down that a bank cannot have a lien over its own indebtedness, and this must apply equally to non-possessory security interests; (iii) a legal assignment under the Law of Property Act 1925 (UK) requires three separate parties, and cannot apply where the bank is both the debtor and the assignee; and (iv) the doctrine of merger applies so as to wholly or partially release the debt on the customer's default.

A fifth ground of objection has been raised in respect to equitable charges over the bank's own indebtedness. Everett has advanced that the equity of the

82 [1970] 3 All ER 473, 477 (per Lord Denning MR); and 487-488 (per Buckley LJ): and on appeal in *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] 1 All ER 641, 653 (per Lord Cross).

83 Refer to pp 377-379.

84 Op cit, p 127.

85 For the New Zealand equivalent see s 130 of the Property Law Act 1952.

86 Op cit, p 125. See also Weaver and Craigie, *Banker and Customer in Australia*, p 614.

87 See for instance: E P Ellinger, *Modern Banking Law*, p 598; Weaver and Craigie, *Banker and Customer in Australia*, 2 ed, ¶ 20.850; J King, "*Broad's Case* and Set-Offs", from *Banking Law and Practice 1986*, pp 51-52; T Shea, "Credit Cards - Retention Clause - Contingent Debts", [1986] 3 JIBL 192, 196; D I Everett, "Security over Bank Deposits" [1988] A Bus L Rev 351, 364; D Pollard, "Credit Balances as Security - I", [1988] J Bus L 127, 137-138.

88 D I Everett, "Security over Bank Deposits", [1988] A Bus L Rev 351, 364.

89 Refer to pp 394-395.

case will make it impossible for a Court of Equity to require the customer to hold the debt for the benfit of the bank.

The cases discussed above, and all the commentators who argue against charge-backs, perceive that all the bank can receive from a contract purporting to grant a charge-back is the contractual right of set-off. As King stated at a seminar for the Australian Banking Law Association:[90]

> As Lee J pointed out in *Broad's case* [[1980] 2 NSWLR 40, 46] it is well established that it is not possible for the financier to take a charge over its own liability - its liability to repay the deposit. If one analyses what in fact the financier wishes to do, it is simply to obtain the right to modify the contractual liability to repay the deposit and so as to be able to deduct from the financier's liability the amount of the customer's liability; in other words, the right to set-off the customer's liability against the financier's liability.

IV. Authorities Favouring Charge-backs

1. *The Commonwealth authorities*

There are a number of Commonwealth cases which seem tacitly to approve of charge-backs,[91] but none of them discuss any of the conceptual problems that have been argued against charge-backs and none of them expressly rule that the security interest is possible. And in only one case was the issue expressly put before the court.[92] The cases are indeed of limited value in analysing charge-back legitimacy. But they do exemplify a presumption that such transactions are regarded as valid.

Ex parte MacKay[93] and Swiss Bank Corporation v Lloyds Bank Ltd[94] are the cases that have the greatest bearing on this issue. Neither were referred to in any of the cases which expressly prohibited charge-backs, nor in *Halesowen* or the *MPS Construction* case. *Ex parte Caldicott*,[95] while being of lesser assistance to the charge-back cause, was briefly discussed by Millett J in *Re Charge Card Services Ltd.*

2. *Ex parte MacKay*

Jeavons sold a patent to Brown & Co in return for receiving royalties over a period of 6 years. Brown & Co contemporaneously lent to Jeavons £12,500, and as security Brown & Co retained half of the royalties that were to be paid. Jeavons went into bankruptcy and his trustee in bankruptcy argued, *inter alia*, that the security was void because "[a] man cannot have a charge on a debt which is due from himself."[96] In the report recorded in the Law Journal, Mellish LJ is reported to have asked in argument in response:[97]

> Might there not have been such an agreement before the laws of set-off? Why cannot a man have a charge on a debt due from himself as well as on the debt due from another?

90 J King, "*Broad's Case* and Set-Offs", from *Banking Law and Practice 1986*, p 51.

91 *Re Hart, ex parte Caldicott* [1883] 25 Ch D 716, 721-722; *Hutt v Shaw* (1887) 3 TLR 354, 355; *Commercial Bank of Australia Ltd v Wilson* [1893] AC 181, 185; *Re City Equitable Fire Insurance Co (No. 2)* [1930] 2 Ch 293, 312; and *Swiss Bank Corporation v Lloyds Bank Ltd* [1982] AC 584, 595, 610. See also the Canadian cases of *Clarkson v Smith & Goldberg* (1925) 58 OLR 241, 242; and *Re Century Steel & Boiler Ltd* (1981) 36 NBR (2d) 490, 497; 94 APR 490, 497.

92 *Ex Parte MacKay* (1873) LR 8 Ch App 643, 646; 42 LJ Bankr (NS) 68, 69.

93 (1873) LR 8 Ch App 643; 42 LJ Bankr (NS) 68.

94 [1982] AC 584, 595.

95 [1883] 25 Ch D 716.

96 (1873) LR 8 Ch App 643, 646; 42 LJ Bankr (NS) 68, 69.

97 (1873) 42 LJ Bankr (NS) 68, 69.

Both James and Mellish LJJ held that the security agreement in respect of half of the royalties was valid security. The court clearly assumed that the security agreement was intended to give Brown & Co a charge over its own indebtedness to Jeavons. James LJ stated:[98]

I entertain no doubt that there is a good charge upon one moiety [half] of the royalties, because they are part of the property and effects of the bankrupt.

Given the fact that the issue of charge-back legitimacy was raised in argument, though apparently not analysed rigourously, and that the charge-back was subsequently upheld, some authority is provided which suggests that *Broad's* case, *Estate Planning Associates* and *Charge Card Services*, none of which referred to this case, were all wrongly decided. Indeed the headnote to the report of the decision in the Law Journal states boldly "A creditor may have by contract a good charge for his debt on sums to become due from himself to the debtor."[99]

3. *Ex parte Caldicott*

Hart mortgaged his real estate to secure a partnership overdraft account, of which he was partner with his son. Hart later sold the property, and the bank took security over the proceeds. He was not entitled to withdraw any of the principal of the deposit until the partnership account had been fully repaid. The security over Hart's account was held to be valid although there was no discussion as to the conceptual possibility of charge-backs.[100]

4. *Swiss Bank Corporation v Lloyds Bank Ltd*

In this case a complex financial arrangement was entered into in order to facilitate the purchase of stock in an newly established Israeli bank. Swiss Bank advanced the funds to IFT on condition that IFT hold the acquired stock on a separate account and make repayment from the proceeds of sale of the stock. The stock were in turn to be held by an authorized depositary. At a later date IFT granted to Lloyds an equitable charge over the shares held at the depositary. Swiss Bank applied for an order that it was to be considered as the chargee of the stock and that Lloyds charge should be defeated. Browne-Wilkinson J held that the charge to Swiss Bank was valid and the charge to Lloyds void. The appeals to the Court of Appeal[101] and then to the House of Lords[102] were both unsuccessful. The importance of this case to the charge-back controversy is the obiter comments of Buckley LJ which received approval in the House of Lords. The judge stated:[103]

It follows that whether a particular transaction gives rise to an equitable charge of this nature must depend upon the intention of the parties ascertained from what they have done in the then existing circumstances. The intention may be expressed or it may be inferred. *If the debtor undertakes to segregate a particular fund or asset and to pay the debt out of that fund or asset, the inference may be drawn, in the absence of any contra intention, that the partyies' intention is that the creditor should have a proprietary interest in the segregated fund or asset as will enable him to realise out of it the amount owed to him by the debtor.* . . . [Emphasis added]

98 (1873) LR 8 Ch App 643, 647; 42 LJ Bankr (NS) 68, 70.
99 (1873) 42 LJ Bankr (NS) 68, 68.
100 [1883] 25 Ch D 716, 721-722.
101 [1982] AC 584. The judgment of the court was given by Buckley LJ.
102 [1982] AC 610. The judgment of the court was given by Lord Wilberforce.
103 [1982] AC 584, 595.

Therefore a charge can be created without the parties intending it. It is accomplished by segregation of a particular fund with the intention that the debt be satisfied from it. There is obvious application to the charge-back situation where the customer agrees to allow his deposit account to be used for satisfying an overdrawn account in the event of default. The deposit account must be segregated, but this will occur on the facts anyway. It is however true that the judge was not directly considering the issue whether a bank can obtain a charge over a debt owed by it to its customer. Nevertheless there are comments in Lord Wilberforce's judgment which suggest that the House of Lords assumed the legitimacy of charge-backs.[104] He referred to a clause in the loan agreement between Swiss Bank and IFT which contained an express charge on the debt represented in IFT's bank account with Swiss Bank. No objection was raised on this particular ground to the charge by the judge.

Buckley LJ's comments have also caused some concern among banking lawyers. Not only does this statement seem to apply to charge-backs but also to contractual set-off situations.[105] This has resulted in some banks treating contracts of set-off as creating charges on the book debts of depositors.[106]

5. *Other cases supporting charge-backs*

The other English cases have really done no more than to presume the legitimacy of charge-backs.[107] The dearth of direct authorities on this point in the Commonwealth is peculiar in light of the two opposing schools of thought which have developed particularly in the last decade.

There are two similar Canadian cases. Neither has examined the principled basis of charge-backs nor has expressed an objection to their use. In *Clarkson v Smith & Goldberg*[108] a partner was sued by the liquidators of a bank for a partnership debt which he had secured with the amount in a deposit account with the same bank. The security agreement provided that the securities and proceeds were to be held by the bank "as a general lien and continuing collateral security for payment of the indebtedness and liability" of the partnership. Hodgkins JA, delivering the judgment of the Ontario Court of Appeal, in referring to the fact that no lien could be given over debts, stated:[109]

> The bank has no true lien upon deposits in its hands, as pointed out in *Royal Trust Co v Molsons Bank* (1912) 27 OLR 441, but by the hypothecation agreement the debt of the bank to the partner for his deposit was in effect assigned to the banker....

What is important is that the court saw no objection to viewing the agreement as effecting an assignment to the bank of the debt owed to the partner by the bank.

Meanwhile in the second case, *Re Century Steel & Boiler Ltd; Victoria Adleman Holdings Ltd v Coopers & Lybrand Ltd*,[110] a landlord retained $1,900

104 [1982] AC 584, 614.

105 See also *Gorringe v Irwell India Rubber & Gutta Percha Works* (1886) 34 Ch D 128, 134 (per Cotton LJ).

106 W J L Blair, "Charges over Cash Deposits", (1983) IFL Rev 14, 15. But see *Re Brightlife Ltd* [1986] 3 All ER 673 where it was held by Hoffman J that a credit balance at a bank did not amount to a "book debts and other debts" as described within a debenture. Therefore a charge over a deposit at a bank may not need to be registered. However see the practice direction by the Registrar of Companies in The Company Lawyer, Vol 9, No 4, p 107 which states that in spite the ruling in *Re Charge Card Services Ltd*, "register such securities if presented for that purpose".

107 See the cases cited at n 91.

108 (1925) 58 OLR 241 (Ont CA).

109 Ibid, at 242.

110 (1981) 36 NBR (2d) 490; 94 APR 490 (NBCA).

on security for the payment of rents. The tenant became bankrupt with a large amount of rent in arrears. The judgment of the New Brunswick Court of Appeal, delivered by Hughes CJ, held that the landlord had a valid charge against the $1,900 retention fund. He said:[111]

> However, in my opinion the lessor was, to use the wording of the definition of "secured creditor", "a person holding a *pledge*" or "*charge* on or against the property of the debtor as security for a debt due or accruing due to him from the debtor".
> I have reached the conclusion that the lessor held a pledge of the security deposit or had a charge against the deposit and as such was a secured creditor to the extent of the $1,900.00 security deposit.

6. *The Commonwealth authorities in summary*

The two Canadian cases are directly on point and it is unfortunate that the wisdom of those judges was not more searchingly directed towards the conceptual problems, which have captured the interest of so many commentators.[112] However the issue was raised in Ex parte MacKay and, though the actual decisions provide little to hail as a definitive statement on the point, there was an assumption by the judges that security agreements of this nature are valid. In short, at least up until the decision of Lee J in Broad v Commissioner of Stamp Duties there was a clear presumption among the judiciary in the Commonwealth that charge-backs were valid. The three cases that argue against this "presumption" should not be regarded as having settled the issue.[113]

7. *United States authorities*

Security interests in deposit accounts granted by the customer to the bank to secure its own indebtedness are common and are frequently given effect to in the United States.[114] As stated in *People's National Bank of Washington v United States*:[115]

> Under the common law, a creditor may protect its interest in a deposit account by means of a pledge or an assignment

However, there seems not to have been any detailed analysis of the conceptual possibility of charge-backs.[116] There appears to be no authority for

111 Ibid, at 496-497.

112 For those commentators that have commented or argued in favour of charge-backs see for example: M Hapgood, *Paget's Law of Banking*, 10 ed, p 526; P J Cresswell et al, *Encyclopaedia of Banking Law*, ¶ 2486; P R Wood, *English and International Set-Off*, ¶ 5-134 et seq; R Turner, "Broad's Case and Set-Offs", from *Banking Law and Practice 1986*, pp 63-67; R Calnan, "Securing Cash Deposits in England", (1989) JIBFL 297, 300; R Baxt, (1987) 61 ALJ 662, 664; and W G Bellack-Viner, "Security over Bank Deposits: The Aftermath of *Re Charge Card Services Ltd*", (1990) 6 BFLR 82. And from an American standpoint arguing in favour of the legitimacy of charge-backs see D L Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection - The Common Law is Alive and Well", [1989-90] 39 Drake L Rev 259.

113 See the rejoinder to the arguments of those that urge the conceptual impossibility of charge-backs at pp 390 et seq.

114 The Official Comment (No 7)(1972) to the Uniform Commercial Code, contained in R A Anderson's, *Uniform Commercial Code*, 3 ed, The Lawyers Co-operative Publishing Co, Rochester, NY, 1985.
For example: *People's National Bank of Washington v United States* 777 F 2d 459, 461 (CA9, 1985); *Walton v Piqua State Bank* 466 P 2d 316, 329 (1970); *Miller v Wells Fargo Bank International Corporation* 406 F Supp 452, 468-473, 477-479 (SDNY, 1975), affd 540 F 2d 548 (CA 2, 1976); *Kaw Valley State Bank & Trust v Commercial Bank of Liberty, NA* 567 SW 2d 710, 712 (Mo Ct App, 1978); *Willis v National Bank of Georgia* 334 SE 2d 917 (Ga Ct App, 1985); and *Jefferson Bank and Trust v United States* 894 F 2d 1241 (CA10, 1990).

115 777 F 2d 459, 461 (CA9, 1985).

116 Included within the rubric of "charge-backs" will be both the United States security assignment and the pledge.

the proposition that charge-backs are conceptually impossible. Instead there seems to have been a general assumption that charge-backs are valid, and they have been well accepted as forms of deposit account financing. The contentious issues on charge-backs in the United States have related more to how such security agreements can be created.[117]

V. A Rejoinder

1. *Bank has no need to sue itself*

The bank does not need to resort to suing itself in order to enforce the charge. The distinction to be drawn here is between the customer's remedy against the bank in relation to the debt, and the bank's recourse under the security interest to the collateral, so as to satisfy the debt in the event of the customer's default. Whereas the customer's rights in respect of the debt allow him to sue the bank in the event of the bank failing to repay him on demand, under the terms of the security agreement, the remedies open to the bank upon the customer's default allow realization of the security by exercising a contractual right to set-off the accounts.[118] As the right to set-off is incorporated in the security agreement, it will take effect as to its terms and will not be subject to the limitations of mutuality in statutory set-off.[119]

Support for this proposition is gained from the approach the courts have taken towards enforcement of security agreements generally. From an early period the courts have permitted the parties expressly to stipulate remedies in the event of the debtor's default.[120] As Wigram V-C stated in *Sampson v Pattison*:[121]

> The only question is, what are the terms of the contract?

There is no reason in law or in policy why the parties cannot have provided for the secured creditor, the bank, to have an effective right of set-off in the event of the debtor, the customer, defaulting on his obligations under the security agreement. Indeed, in policy there is a reason to encourage it. The expenses of foreclosure, which will inevitably be borne by the debtor, will be negligible.

Furthermore, it has been argued by Wood[122] that an unenforceable debt is still a debt. He refers to two cases[123] which support this proposition. Of course the bank will be unable to sue itself. Hence the debt will be unenforceable upon being charged; but it will remain a debt which will become enforceable upon the reassignment of the debt to the customer, when the terms of the credit agreement have been fulfilled.

117 See B Clark, *The Law of Secured Transactions Under the Uniform Commercial Code*, 2 ed, Warren, Gorham & Lamont, Boston, 1988; D L Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection - The Common Law is Alive and Well", [1989-90] 39 Drake L Rev 259; A C Harrell, "Security Interests in Deposit Accounts: A Unique Relationship Between the UCC and Other Law", 23 UCCLJ 153 (1990); G T McLaughlin, "Security Interests in Deposit Accounts: Unresolved Problems and Unanswered Questions Under Existing Law", 54 Brooklyn L Rev 45 (1988); L E Zubrow, "Integration of Deposit Account Financing into Article 9: Proposal for Legislative Reform", 68 Minn L Rev 899 (1984).

118 See for example R Derham, *Set-Off*, p 302.

119 As to statutory set-off see s 93 of the Insolvency Act 1967.

120 W J Gough, *Company Charges*, Butterworths, London, 1978, p 15.

121 (1842) 1 Hare 533, 535; 66 ER 1143, 1143.

122 *English and International Set-Off*, ¶ 5-180.

123 *Curwen v Milburn*, (1889) 42 Ch D 424; and *Re Carter*, (1885) 55 LJ Ch 230.

2. *Bank cannot have a lien over its own indebtedness? Halesowen Press-work v Westminster Bank distinguished*

Much of the charge-back controversy revolves around obiter comments of Buckley LJ that a bank could not have a lien over its own indebtedness. The judge said:[124]

> *No man can have a lien on his own property*, and consequently no lien can have arisen affecting that money or that credit. The amount of the credit of the plaintiffs on the No 2 account was, of course, increased, but this credit represented indebtedness by the bank to the plaintiffs as its customer, and *I cannot myself understand how it could be said with any kind of accuracy that the bank had a lien on its own indebtedness* to the plaintiffs. It has, of course, long been recognized that a banker has a general lien on all securities deposited with him as banker by a customer unless there be an express contract or circumstances that show an implied contract inconsistent with lien: see *Brandao v Barnett* [(1846) 3 CB 519, 531, [1843-60] All ER Rep 719, 722], per Lord Campbell. *The term 'securities' is no doubt used here in a wide sense, but does not, in my judgment, extend to the banker's own indebtedness to the customer.* [Emphasis added]

There appears to be two reasons for Buckley LJ having found no lien could arise from this passage. There is possibly a third. First, no person can have a lien over his own property. This must be correct. A lien allows retention of property until a debt owed to the creditor is paid. There could be absolutely no benefit to the creditor if he retained possession of his own property, which he is entitled to do anyway, until the debtor has satisfied the debt. Not only is it illogical for a creditor to hold his own property as security for a debt owed to him, but it is untenable.

Secondly, a lien can only apply to a physical object. It is a possessory security device.[125] In deposit account financing a lien may arise on the securities of the customer that have come into the bank's possession as banker.[126] But it is inconceivable that a lien could arise in relation to the customer's debt owed by the bank as the bank has no object which it can retain.

As recorded it has been argued that there was a third reason behind Buckley LJ's obiter.[127] But on examination this is not necessarily correct. The "third reason" arises from the judge's stated inability to "understand how it could be said with any kind of accuracy that the bank had a lien on its own indebtedness".[128] It is not a positive statement of law, but rather a negative statement as to the judge's understanding, with the inference that no person can have a lien over his own indebtedness. Having made that inference the statement is clear. However, the statement cannot be looked at in isolation. After making the statement the judge immediately embarked on a discussion of what a banker's lien can apply to - "securities" of its customer. The judge said that a lien applied to "securities" (because a lien is a possessory security interest) but that "securities" did not "extend to the banker's own indebtedness to the customer".[129] The conclusion to be drawn from this statement is that the bank's own indebtedness could not be the subject of the lien for the simple reason that it was not a "security" - it was a pure intangible. There was

124 [1970] 3 All ER 473, 487-488.

125 See pp 375-376.

126 A banker's lien will not arise over property deposited with the bank for a specific purpose, such as to be held in a safety deposit account. In short the bank must receive the property inside its creditor-debtor relationship: see *Brandao v Barnett* (1846) 3 CB 519, 533; 136 ER 207, 213; [1843-60] All ER Rep 719, 720 (Lord Campbell).

127 See p 380 and pp 382-385 above.

128 [1970] 3 All ER 473, 487.

129 Ibid, at 488.

absolutely no suggestion that the bank could not retain, for instance, a certificate of deposit representing the indebtedness as security for an advance to its customer. When viewed as a whole the comments of the judges in the Court of Appeal and House of Lords can be taken no further than making the distinction between a lien and a banker's right to combine the accounts of its customer.[130] The comments should not be taken as authority for the proposition that a bank cannot be granted a charge-back over its own indebtedness by its customer.

The comments in *Halesowen* in respect of a banker's lien have been taken to apply to charge-backs. It has been expressly held that it is not possible for a bank to have a charge on its own indebtedness on the basis of *Halesowen*.[131] However, a banker's lien is a completely different security interest to a charge-back. While the bank is incapable of having a lien over a debt owed by it to a customer, it does not follow that a charge cannot be held by the bank over the same property. There are two fundamental distinctions between possessory and non-possessory security interests in deposit accounts. There cannot be a lien over a bank deposit for two reasons: (a) the only thing which the customer possesses in respect of a bank deposit is a chose in action - a debt. That chose in action is intangible property and cannot for that reason be the subject of a lien.[132] (b) The property, or legal ownership, in the customer's deposit is with the banker.[133] However, in respect of a charge: (a) intangible property has long been capable of being the collateral for a charge; and (b) the property in the deposit (the money) is with the bank, but the property in the debt (which is the subject of the charge) is with the customer.[134]

3. *Notice of legal assignment under the Law of Property Act 1925*[135]

It has been argued that the statutory provisions dealing with legal assignment require three parties: the assignor, assignee and debtor. Section 136(1) provides for legal assignment of debts. The relevant part of that section provides:

> (1) Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other thing in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to claim such debt or thing in action, is effectual in law (subject to equities having priority over the right of the assignee) to pass and transfer from the date of such notice
>
> (a)the legal right to such debt or thing in action;
>
> (b)all legal and other remedies for the same; and
>
> (c)the power to give a good discharge for the same without the concurrence of the assignor:

130 A similar conclusion was reached by Wood in his monograph *English and International Set-Off*, ¶¶ 5-176 to 5-177. See also R Derham, *Set-Off*, p 302.

131 *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40, 46; *Estates Planning Associates Pty Ltd v Commissioner of Stamp Duties* (1985) 2 NSWLR 495, 499; and *Re Charge Card Services Ltd* [1986] 3 All ER 289, 308.

132 See the comments in *Halesowen Presswork v Westminster Bank* [1970] 3 All ER 473, 477 (per Lord Denning MR); 487-488 (per Buckley LJ).

133 *Foley v Hill*, (1848) 2 HL Cas 28, 35; 9 ER 1002, 1005 (per Lord Lyndhurst LC): and 44; or 1008 (per Lord Brougham).

134 *Croton v R*, (1967) 117 CLR 326, 330; (1967) 41 ALJR 289, 291 (per Barwick CJ).

135 It was the Courts of Equity that first gave recognition to assignment of debts . Assignment at law was, with two exceptions (in respect of negotiable instruments and assignments to and by the Crown: see L A Sheridan, *Rights in Security*, p 270), not possible until it was given statutory effect under Section 25(6) of the Supreme Court of Judicature Act 1873 (UK). It is now represented in s 136 of the Law of Property Act 1925 (UK) and throughout the Commonwealth in similar or identical terms. See for instance the New Zealand equivalent contained in s 130 of the Property Law Act 1952.

While the provision clearly does contemplate the existence of three parties (assignor, assignee and debtor), it is difficult to see why one must infer from this that a charge-back, involving only two parties, is legally impossible. There seems no reason why the assignor, the customer, cannot give notice to the debtor, the bank, of the assignment. The bank, as assignee, will be made aware of the assignment when it is granted a legal mortgage over the property and there seems no policy reason why this should not suffice as notice to the bank as debtor also.

Furthermore, this provision only applies to legal mortgages of debts. Section 136 has in no way limited the ability of the customer to grant an equitable assignment of the debt under an equitable mortgage,[136] nor to restrict the availability of the equitable charge as a security interest.

4. *Is there merger of interests?*

This issue follows on from the discussion as to the statutory provisions relating to notification of mortgages over debts. Section 136(1) of the Law of Property Act requires that the assignment be absolute. The assignment must not purport "to be by way of charge only". This does not preclude the provision for the debt to be reassigned if certain events occur, but the original assignment must be absolute.[137] The assignment under a legal mortgage, despite being subject to a conditional reassignment, has been held to be absolute.[138] This has led those who argue against the legitimacy of charge-backs to argue that a legal or equitable mortgage operates as a conditional release of the debt and that upon default by the customer the debt is wholly or partially released. However the debt will not necessarily be released automatically upon the customer's default.

The doctrine of merger applied at common law and in equity. Its application has been more associated with real property transactions, although its application extends to all property. Cheshire and Burns describe the doctrine as applying:[139]

> . . . where a lesser and a greater estate in the same land come together and vest, without any intermediate estate, in the same person and in the same right, the lesser is immediately annihilated by operation of law. It is said to be "merged", ie, sunk or drowned, in the greater estate.

The common law took an approach which did not call upon an enquiry into the intentions of the parties. Meanwhile equity took quite the opposite approach. The intention and the duties of the parties, as evidenced in and outside of the contractual document, could entitle the party whose interests were being merged at common law to an order that merger had not occurred in equity.

The essential precondition for merger, whether in law or in equity, is that the rights and liabilities of a contract become vested in the same person and in the same right.[140] Therefore, while it is true that the law of merger will

136 See comments in L A Sheridan, *Rights in Security*, pp 273-274.

137 See *Tancred v Delagoa Bay & East Africa Railway Co* (1889) 23 QBD 239.

138 *Burlinson v Hall* (1884) 12 QBD 347; *Tancred v Delagoa Bay & East Africa Railway Co* supra; *Cronk v McManus* (1892) 8 TLR 449; and *Hughes v Pump House Hotel Co Ltd* [1902] 2 KB 190.

139 G C Cheshire and E H Burns, *Modern Law of Real Property*, 13 ed, Butterworths, London, 1982, p 851, adopting the words of Sir William Blackstone, *Commentaries on the Laws of England*, Clarendon Press, Oxford, 1766, Book II, Ch II, p 177.

140 *Chambers v Kingham* (1878) 10 Ch D 743. There an executor purchased an interest in the property which he held for the purposes of an administration. There was no merger of interests because, though the same person was vested with the rights and obligations in respect of the property, he

operate wholly or partially to release a debt which has been assigned by a customer to a bank, this only applies where the bank receives the debt as assignee. When the debt is assigned by the customer to the bank under a legal or equitable mortgage, the bank receives the debt not as a creditor but as chargee. The debt has not just been assigned. It has been assigned by way of security. While one of the effects of the mortgage has been an assignment, there remains with the customer an equity of redemption. The equity of redemption entitles the customer to recover the legal or equitable title to the property, the subject of the legal or equitable mortgage. Effectively it entitles the customer, as chargor, to require and enforce reassignment of the debt.[141]

At any rate, equity has not allowed merger of interests where it is clearly disadvantageous to the party in whom the interests would merge.[142]

5. *Equitable principles*

Everett has suggested that there is a further reason for an equitable charge over the bank's own indebtedness to be regarded as improper.[143] She based her argument on the very nature of the equitable charge. She maintained that as the equitable charge was an equitable remedy a court would not require the customer to hold the debt for the benefit of the bank when it was already within the bank's control as to when to repay the debt. There are two reasons why this must be wrong.

With the equitable charge over the bank's own indebtedness the debt, is not assigned to the bank. It confers upon the chargee a proprietary remedy, but does not convey recognized ownership interest in the debt.[144] The equitable charge is only a mere encumbrance attaching to the debt. All the bank will have, in the event of the customer's default, is to have "a right to payment out of a particular fund or particular property".[145] In effect the customer will be under an obligation to hold the debt for the benefit of the bank. The bank owns the money in the account and can do as it wishes with the money.[146] It owes the customer the debt. It makes payment to or on behalf of the customer in satisfaction of that debt on the instructions of the customer. The logical conclusion is, therefore, that the bank can itself control the payment of the debt and will not therefore have to apply to a court for an order requiring the customer to hold the debt for its benefit. But does this negate the possibility of an equitable charge arising in such situations? Equity will look to the parties' intentions and subsequent actions to bring about a result between those parties which is based on concepts of justice and fairness. The fact will be that the parties intended the bank to receive an encumbrance over its own indebtedness to the customer.

The equitable charge will not grant to the bank a recognized ownership right in the debt. It is therefore conceivable that the customer may breach his duty to hold the debt for the bank by assigning the debt, subsequent to the grant of the equitable charge, to a third person. In this situation the bank may

did not receive the beneficial interest in the same right as that held as executor.

141 See the comments of R Turner, "Broad's Case and Set-Offs", p 67.

142 G C Cheshire and E H Burns, op cit, p 852 citing *Ingle v Vaughan Jenkins* [1900] 2 Ch 368 and *Re Fletcher* [1971] 1 Ch 330.

143 D I Everett, "Security over Bank Deposits", [1988] A Bus L Rev 351, 364. And see p 385 above.

144 *National Provincial & Union Bank of England v Charnley* [1924] 1 KB 431, 449-450 (per Atkin LJ).

145 *Tancred v Delagoa Bay & East Africa Railway Co* (1889) 23 QBD 239, 242 (per Denman J).

146 *Foley v Hill* (1848) 2 HL Cas 28, 35; 9 ER 1002, 1005 (per Lord Lyndhurst LC): and 44, 1008 (per Lord Brougham).

well wish to apply to a court for an order that the customer hold the debt for its benefit. While a legal or equitable assignment of a debt is subject to all equities arising before the assignment, therefore giving the bank priority in any event,[147] the bank may quite legitimately not wish an assignment to occur so as to avoid any priority dispute, or for any other reason.

6. *Policy reasons supporting charge-backs*

Deposit account financing is just another form of private bargained for debt collaterization, and as a matter of policy, should be accommodated by legal and equitable principles, provided that legitimate third party interests are protected.[148] There seems no valid justification for having a disparity between third party and banker rights in respect to the obtaining of security over the bank's indebtedness to its customer. Indeed it is anomalous to have such an inequitable distinction.[149]

There are economic policy reasons for allowing charge-backs. A bank, able to obtain a charge over its own indebtedness, will be more willing to advance credit to the customer. Greene[150] cites this passage from an article of Phillips:[151]

> To the extent that a deposit account cannot be utilized as collateral, the debtor is deprived of a major asset on which to borrow; the [creditor - *inter alia*, the bank] is constrained to lend less than [it] otherwise might; and the economic effect is restrictive because potential collateral cannot be used to secure credit.

However, the economic effects are not restricted to the availability of credit. The deposit account, or the debt that it represents, provides an excellent security. It is incapable of depreciating, falling into obsolescence, and with a properly worded security agreement, incapable of being reduced by the debtor. The bank's risks in respect of collateral are therefore reduced. As has been said of the use of the deposit account as collateral:[152]

> Deposit account collateral is preferable in certain respects to some forms of tangible collateral. Difficult valuation problems can be avoided as depreciation and obsolescence need not be considered. In the event of default, foreclosure on a deposit account is less costly than foreclosure on tangible collateral. Particularly where the lender is the depositary institution, modern banking records of daily account actively facilitate inexpensive monitoring of the depositor's compliance with consensual or legal restriction on depletion of the account.

Thus the encouragement of the use of security interests over deposit accounts will enhance the availability of credit while also reducing the ultimate cost of supplying credit. In the competitive financial service industry, the

147 Legal assignment: s 136(1) of the Law of Property Act 1925(UK) and s 130 of the Property Law Act 1952 (NZ) both provide that the legal assignment "is effectual in law (subject to equities having priority over the right of the assignee)...." See also *Re Jones* [1897] 2 Ch 190.
Equitable assignment: See *Christie v Taunton Delmard Lane & Co* [1893] 2 Ch 175, where an equitable assignment by way of equitable mortgage was held to be subordinated to the right of the debtor to set-off the mutual debts with the mortgagor.

148 See D L Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection - The Common Law is Alive and Well", [1989-90] 39 Drake L Rev 259, 264.

149 Refer to the brief discussion of the inequities in respect to the priorities of the parties' interests at pp 403-404 below, where reform is advocated.

150 Op cit, pp 264-265.

151 Phillips, "Flawed Perfection: From Possession to Filing Under Article 9 - Part I", 59 BUL Rev 1, 47 (1979). This article was not available in New Zealand.

152 L E Zubrow, "Integration of Deposit Account Financing into Article 9: Proposal for Legislative Reform", 68 Minn L Rev 899, 918-919 (1984).

reduction of the cost of the supply of credit will lead to a reduction in the cost of credit to the customers of banks.

VI. A Possessory Security Interest over a Customer's Deposit Account?

1. *Liens and pledges*

As earlier recorded, liens and pledges are possessory security interests and as such rely on the retention of actual property by the bank. A bank cannot utilize the actual debt owed by it to its customer, nor any debt owed to the customer, as collateral possessory security. There is simply nothing upon which a lien or pledge can attach.[153]

A lien or pledge can apply over securities deposited with the bank, such as negotiable instruments, share certificates, Government Bonds, bills of lading and the like. However the specific collateral for the two security interests will in practice usually be quite different. This is so because of the very nature of the security interests. Bankers' liens involve the retention of securities deposited with the bank.[154] They attach by operation of law, not according to an agreement between the bank and customer.[155] On the other hand, in this context, pledges apply to securities delivered by the customer to the bank on security for an advance by the bank. Pledges, therefore, require a specific transfer of possession for a specific purpose: security over the customer's indebtedness to the bank.

2. *Liens over deposit accounts*

So what can a lien attach to in respect a deposit account? As has been shown, a bank cannot hold the actual moneys deposited by the customer on a lien as legal title in the moneys passed to the bank on receipt,[156] and "[n]o man can have a lien on his own property".[157] As Falconbridge CJ, said in *Royal Trust Co v Molsons Bank*:[158]

> No doubt, it has been said that the ordinary banker's lien extends to money on deposit with a bank (*vide, eg, Misa v Currie* (1876) 1 App Cas 554, at p 569). But the word "lien" is used in this connection only as a *façon de parler*. "A lien is the right of a person having possession of the property of another to retain it until some charge upon it or some demand due him is satisfied" (Century Dictionary)
> . . .
> But it is well known that in the case of a deposit of money with a bank the relation between the customer and the bank is that of creditor and debtor. There is no specific property of the customer in the possession of the bank upon which the bank can assert a lien.

Given that the bank has no lien over moneys deposited with it, the property which will most often form the subject of a lien in respect of the actual deposit account will be cheques deposited by or on behalf of the customer.[159] Most

153 *Brandao v Barnett* (1846) 3 CB 519, 531; 136 ER 207, 212; [1843-60] All ER Rep 719, 722 (per Lord Campbell).

154 See *Brandao v Barnett* supra.

155 But Lord Inglis in *Robertson's Trustee v Royal Bank of Scotland* (1890) 18 R 12, 16, has stated that the banker's lien applies to "all unappropriated negotiable instruments belonging to the customer in the hands of the banker for securing his balance on general account."

156 *Foley v Hill* (1848) 2 HL Cas 28, 35; but contrast with statements made by Lord Hatherley in *Misa v Currie* (1876) 1 App Cas 554, 569 that a lien could extend to moneys held in a deposit account.

157 *Halesowen Presswork v Westminster Bank* [1970] 3 All ER 473, 487 (per Buckley LJ).

158 (1912) 27 OLR 441, 444.

159 As, for example, occurred in *Halesowen Presswork v Westminster Bank* supra, up until the cheque was presented by Westminster Bank for payment at the drawer's bank.

other securities over which a security interest will apply, will involve the customer voluntarily presenting them as collateral under a pledge. It would be rare for these securities, such as certificates of deposit and deposit account passbooks, to be in the bank's possession without this specific transfer by the customer, unless they were held by the bank in a safety deposit box. However a bank can only have a lien over property which it holds as banker, that is, in its capacity as a moneylender, and cannot have a lien over property held by it as bailee.[160] Any property held in a safety deposit box by the bank will therefore not be capable of being retained under a banker's lien.

3. *Pledges over deposit accounts*

A pledge depends on the customer depositing with the bank securities as collateral for the customer's indebtedness to the bank and will, therefore, usually take the form of share certificates, debentures and certificates of deposit. So what can the bank do to collaterize the deposit account of its customer. The practice generally adopted by banks has been to issue a certificate of deposit to the customer in respect of the amount standing in the deposit account, and then to hold the certificate as security for an advance to the customer.[161] The advantages of this approach, as stated by Calnan, are that the pledge is not registrable and the *Charge Card Services* problem does not apply to pledges. However, administration continues to be a problem, as do negative pledges in the loan agreements of the customer with other creditors, and there may also be administrative inconvenience for the bank in issuing and then taking as a pledge the certificates of deposit.[162]

It has been argued by Ellinger that a bank cannot obtain pledge over a certificate of deposit issued by the bank to its customer.[163] The grounds for the objection are based on the nature of the certificate of deposit. The problem lies in the fact that a the amounts covered by the certificate are still recorded as a debt in the deposit account. To put it in other words, the issuance of the certificate does not cause an immediate debit to the customer's account. Such a debit occurs upon the presentation of the certificate for payment. Under the United Kingdom equivalent of the New Zealand Section 53 of the Bills of Exchange Act 1908, the "bill of itself does not operate as an assignment of funds", and the bank will be unable to enforce the certificate in the customer's insolvency.

However, Ellinger's argument does not hold true if a different form of negotiable instrument is used, in which the deposit account is debited by the face value of the instrument. In this event the instrument has a life of its own and is not represented in any other form. The funds are represented in the instrument itself. The debt, as represented by the balance of the deposit account, is reduced to the extent of the face value of the instrument. Effectively the customer has purchased from the bank a negotiable instrument. The debt is wholly reliant on the instrument. The negotiable instruments that have the effect of causing an immediate debit to the customer's deposit account on issuance, are a banker's draft, a commercial bill of exchange or note.[164]

160 *Brandao v Barnett* supra. And see generally L A Sheridan, *Rights in Security*, p 213.

161 See R Calnan, "Securing Cash Deposits in England", (1989) JIBFL 297, 300. For an example of a case in which a certificate of deposit was utilized as security for the bank's own indebtedness see *Montavan v Alamo National Bank* 554 SW 2d 787, 791 (Tex Civ App, 1977).

162 Calnan, "Securing Cash Deposits in England", (1989) JIBFL 297, 300.

163 See E P Ellinger, "The Use of NCDs as Security", [1989] J Bus L 64, 65-66.

164 See E P Ellinger, op cit, p 65.

Notwithstanding this, it has been argued by Professor Goode that a pledge given by a customer to his bank over the bank's own paper, is not possible.[165] The negotiable instrument has no legal existence until it has been issued, that is, signed and delivered by the issuer (the bank) to another party (the customer). The transfer of the instrument back to the bank will, Goode argued, cause it to cease to be in issue for as long as it is held by it. And if the bank has either bought the instrument or advanced its full face value, and then holds it until maturity, it is discharged. He cites Section 61 of the Bills of Exchange Act 1882 (UK) for this proposition.[166] If on the other hand, the bank has advanced to its customer less than the face value of the negotiable instrument, then the bank is liable to pay the balance due upon maturity, and the payment will discharge the instrument. Until maturity the instrument is in suspense unless it is transferred back to the customer or delivered to a third party. It is in suspense because the bank as holder of the negotiable instrument is unable to sue the drawer, itself.

Goode's arguments can be countered briefly. Section 61 of the Bills of Exchange Act 1908 provides that:

> Where the acceptor of a bill is or becomes the holder of it in his own right, *at or after its maturity*, the bill is discharged.

The currency of the negotiable instrument is therefore not affected just because *prior to the date of maturity* the instrument comes into the bank's possession under a security arrangement.[167] The instrument will not be discharged until that event. There is never any question of the bank not being capable of enforcing its security, even in the event of the customer's insolvency, for the reasons already discussed. The fact that the negotiable instrument falls into suspense while the bank has possession of it will not impair the security. The security is that the moneys owing to the customer by the bank are secured in the instrument itself. There is no other property that the customer has in respect of the amount and this has the effect of providing the ultimate security. The customer will simply not be able to reduce the amount of the collateral while the bank retains the certificate. The debt no longer exists under the deposit account.

VII. The Draft Personal Property Securities Act - Does it Remedy the Situation?

1. *An introduction to the draft PPSA*

In its report *A Personal Property Securities Act for New Zealand*,[168] the New Zealand Law Commission proposes the reform of the current formalistic approach to secured transactions. The Report proposes an integration of the various personal property securities registries with the intention of providing a uniform registration system for secured transactions, extending to almost all forms of collateral. The Law Commission's recommendation follows

165 R M Goode, *Legal Problems of Credit and Security*, 2 ed, pp 129-130.

166 Section 61 of the Bills of Exchange Act 1908 (NZ), which is in identical terms to its United Kingdom counterpart, provides:
61. Where acceptor the holder at maturity Where the acceptor of a bill is or becomes the holder of it in his own right, at or after its maturity, the bill is discharged.

167 See E P Ellinger, op cit, p 64.

168 *A Personal Property Securities Act for New Zealand (Report No 8)*, Government Printing Office, Wellington, 1989.

extensive research into similar uniform securities legislation in some of the jurisdictions of North America.[169]

2. *The draft PPSA and deposit account financing - generally*

The draft Personal Property Securities Act ("draft PPSA"), like its North American counterparts, does not offer solutions to the problems created by the three cases which specifically adopt an unfavourable approach to charge-backs.[170] In fact none of the uniform codes have specifically attended to deposit account financing. The United States Uniform Commercial Code ("UCC")[171] expressly excludes from its scope the right to set-off and security interests over deposit accounts,[172] on the basis that "[s]uch transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law".[173] Meanwhile the Canadian legislation and the New Zealand draft PPSA have not excluded security interests over deposit accounts from their application. The same applies for set-off but not of the banker's lien.[174] But while the Canadian legislation and the New Zealand draft Act seem to anticipate a deposit account as collateral[175] there are some mechanical issues, recognized by the drafters of the UCC, that have not been addressed.[176]

3. *Deposit accounts and the draft PPSA*

The draft PPSA applies to all security transactions where a security interest is created.[177] "Security interest" is very broadly defined by Section 4 to include, *inter alia*, an interest in "a security", "a negotiable instrument", "money" or "an intangible" which is created by a transaction that in substance secures payment or performance of an obligation.[178]

At this stage it is well to remember exactly what property is the subject of the security interest under the draft PPSA. It is recalled that in respect of non-possessory security interests, the property of the customer which is charged, is the debt owing by the bank. Possessory security interests, however, rely on the retention of the property of the customer and can therefore only apply in respect of the securities representing the deposit. In respect to pledges, the security usually transferred to the bank will be a negotiable instrument.

169 The Law Commission's draft Personal Property Securities Act is based particularly on the British Columbia Personal Property Security Bill 1988 (see now the British Columbia Personal Property Security Act 1989, c 36, "BC PPSA"), but also on the Ontario Personal Property Security Bill 1988 (see now the Ontario Personal Property Security Act 1989, c 16, "Ont PPSA") and the United States Uniform Commercial Code.

170 *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40; *Estate Planning Associates v Commissioner of Stamp Duties* (1985) NSWLR 495; and *Re Charge Card Services Ltd* [1986] 3 All ER 289.

171 Secured transactions in the United States are governed by each State's legislation based on Article 9 of the Uniform Commercial Code.

172 §§ 9-104(i) and (l).

173 The 1972 Official Comment to the UCC, from R A Anderson, *Uniform Commercial Code*, 3 ed, The Lawyers Co-operative Publishing Co., Rochester, NY, 1985.

174 See s 4(5)(a) in respect of liens. "A lien, charge or other interest created by any other Act or rule of law" is excluded from the definition of security interest under the draft PPSA.

175 See below.

176 For a synopsis of those mechanical issues which were not covered by the draft PPSA, see R Dugan, "Subordination Agreements, Loan Participations and Deposit Account Financing Under the Draft Personal Property Securities Act", (supra, n 3).

177 Section 5.

178 Section 4(1).

4. *Charge-backs and the draft PPSA*

An "intangible" is defined as personal property other than "(a) goods; or (b) chattel paper; or (c) a document of title to goods; or (d) a negotiable instrument; or (e) a security; or (f) money".[179] Clearly a debt owed to a customer by the bank falls within this definition. It may also fall within the definition of "account receivable" which is "a monetary obligation not evidenced by chattel paper, or by a negotiable instrument or by a security, whether or not it has been earned by performance".[180] An interest created by the transfer of an account receivable is included in the definition of security interest.[181] It is uncertain which of these definitions applies to a debt represented by a deposit account. However, in common parlance the term "intangible" better describes a customer's debt.[182] An account receivable is synonymous with the term "book debt",[183] the current term under which deposit accounts fall under Part IV of the Companies Act 1955,[184] and has itself been the subject of some uncertainty in its application to a customer's debt owed by the bank.[185]

The rules for the attachment and perfection of charge-backs under the draft PPSA are the same as for other security interests over personal property. They are designed to provide a minimum of uncertainty as between creditor and debtor in the case of attachment and in respect of third parties in the case of perfection.[186] A security interest is perfected when "(a) it has attached; and (b) all steps required for perfection under this Act have been completed".[187] Attachment to the collateral occurs under Section 10 when:

(a) value is given by the secured party; and

(b) the debtor has rights in the collateral; and,

except for the purposes of enforcing rights as between the parties

(c) the security interest is enforceable against third parties within the meaning of section 9

The first two requirements cause no real difficulties, and the third only minor problems. Value is given by the bank with the advance of credit and the customer of course has rights in respect of the debt charged - he has the chose in action against the bank. However, Section 9 requires the security agreement to be in writing, and also to describe the collateral so as to make

179 Section 2.

180 Section 2.

181 Section 4(4)(a).

182 The Law Commission's report, *A Personal Property Securities Act for New Zealand (Report No 8)*, describes "intangible" as serving as "a residual classification for any personal property which falls outside the more specific definitions" (p 87). Meanwhile the Ontario PPSA provides in its definition of intangible "all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, monet or securities" (s 1(1)). A chose in action has been explicitly been held by the Ontario Court of Appeal to include the debt of a bank to its customer for moneys on deposit to his credit: *Re Attorney-General for Ontario and Royal Bank of Canada* [1970] 2 OR 467, 469 (per Brooke JA). The term "chose in action" appeared in s 16(2) of the Execution Act 1960, RSO, c 126.

However, the definition of "intangible" in s 1(1) of the BC PPSA is couched in similar terms to that of its New Zealand counterpart.

183 See *A Personal Property Securities Act for New Zealand (Report No 8)*, p 80.

184 Section 102(2)(f).

185 See *Re Brightlife Ltd* [1986] 3 All ER 673 where it was held by Hoffman J that a credit balance at a bank did not amount to a "book debts and other debts" as described within a debenture. That case did not decide that deposit accounts were not chargeable as "book debts" under the Companies Act.

186 See R Dugan, op cit, p 6.

187 Section 14.

it reasonably capable of identification. Description of the collateral is more suited to tangible property where the item has physical attributes which can be described. With non-possessory security interests in deposit accounts the collateral is the debt. It is intangible property of the customer. How can it then be described? The description should include the depositary bank, the customer, the extent of the debt and the number of the deposit account.[188] However this is more a desciption of the deposit account rather than the collateral itself. The description of the deposit account is as far as any description can go of a debt in a bank and must be regarded as satisfying the requirements of Section 9.

Having satisfied the attachment requirements, all that remains is satisfaction of the second limb of Section 14: all the steps required for perfection under the draft Act must have been completed. The draft PPSA sets out a number of provisions which deal with this final stage of perfection. All of the provisions, with the exception of the registration provision, relate to specific security interests. Debts represented by deposit accounts receive no special treatment, unless the debt is represented by proceeds from the sale of collateral.[189] A charge-back and an ordinary security interest over a customer's debt are thus perfected by the filing and registration of a financing statement.[190]

Security interests in the debt owed by a bank to its customer readily fall within the draft Act. There seems no impediment under the proposed legislation to charge-backs.

5. *Pledges and liens over the customer's securities in respect of a deposit account and the draft PPSA*

As stated, the draft PPSA includes within its definition of security interest a transfer of an interest in a security or negotiable instrument. A "security" is defined as "a share, stock, warrant, bond, debenture or similar document " while a "negotiable instrument" means "a bill of exchange, note or cheque within the meaning of the Bills of Exchange Act 1908 but does not include a security".[191] The instruments which may represent the debt owed by the bank to its customer will fall more naturally within the definition of "negotiable instrument". A certificate of deposit, banker's draft, commercial bill of exchange and promissory note clearly fall within the definition of a bill of exchange under the Bills of Exchange Act 1908.[192]

The taking of security by pledge of collateral is specifically dealt with by Section 18. That section provides, subject to the Section 14 requirements, that perfection of the security interest occurs with the possession of the collateral by the secured party when the subject of the security interest is, *inter alia*, a negotiable instrument. The Section 14 requirement, applicable in the case of a negotiable instrument, is the attachment of the security interest. Attachment is simplified for possessory security interests. While the first two requirements of value and debtor rights to the collateral are no different, a security agreement in writing is not necessary under Section 9.[193] The policy behind this is obvious. Possession of the collateral is effective notice to all third parties that the debtor's rights in respect of the property are subject to some restrictions. Dugan comments that perfection by possession in respect of

188 See R Dugan, op cit, p 6.
189 Section 22.
190 Section 19.
191 Section 2.
192 Section 3.
193 See s 9(1)(a).

deposit accounts, does not provide third parties with sufficient notice of the outstanding security interests.[194] This is true in respect of a certificate of deposit, as the certificate operates in much the same way as a cheque drawn on an account. The certificate is a negotiable instrument which may be negotiated with third parties. However the amount of the debt that the certificate represents will not be debited from the customer's deposit account balance until the certificate is presented to the bank for payment.[195] In this way, third parties may be given the impression that the stated balance in the deposit account is free from any security interests. The pledge is perfected on possession of the collateral and there is no need for the filing of a financing statement. This is certainly a deficiency in the draft Act. However the security interest is perfected and its legitimacy cannot be called into question because of the omission. The omission will rather raise questions of priority. But as already argued a pledge of a certificate of deposit may not be adequate security in any event.[196]

These notification problems will not arise when a different form of negotiable instrument is used, in which the deposit account is debited by the face value of the instrument. In this event the instrument has a life of its own and is not represented in any other form. All third parties will, therefore, be appropriately notified of the security interest by the bank's possession of the instrument. The negotiable instruments that would have the effect of causing an immediate debit to the customer's deposit account on issuance, are a banker's draft, a commercial bill of exchange or note.[197]

Therefore the pledge of a negotiable instrument by the customer to the issuing bank has no flaw imposed upon it by the draft PPSA. However, it has not clarified the issue as to whether such a security is in fact effective.

The other possessory security device available to banks is the banker's lien. Liens created under a "rule of law" have been specifically excluded from the scope of the draft Act[198] and therefore the attachment and perfection provisions of the proposed legislation have no impact on the banker's lien.[199] The common law applies.

6. *Set-off and the draft PPSA*

The bank's right to set-off under the common law, statute or contract, has been distinguished from the banker's lien in a number of cases but most noticeably in *Halesowen Presswork & Assemblies v Westminster Bank*.[200] The bank's "security" of set-off therefore does not face the same difficulties as the banker's lien. There is no provision expressly regulating set-off under the draft PPSA. It is thought that the common law right to set-off cannot give rise to a security interest.[201] While it can be regarded as providing security to the bank in respect of mutual debts, it is not "created or provided for by a transaction" and as such cannot qualify as a security interest.[202] But the same may not be true in respect of a contractual right of set-off, particularly when

194 See R Dugan, op cit, p 6.

195 This represents current banking practice. See E P Ellinger, "The Use of NCDs as Security", [1989] J Bus L 64, 65.

196 See pp 397-398 above.

197 See E P Ellinger, op cit, [1989] J Bus L 64, 65.

198 Section 4(5)(a) of the draft PPSA; s 4(1)(a) of the BC PPSA and Ont PPSA.

199 See W G Bellack-Viner, "Security over Bank Deposits: The Aftermath of *Re Charge Card Services Ltd*" (1990) 6 BFLR 82, 85.

200 [1970] 3 All ER 473, 477 (per Lord Denning MR); 487-488 (per Buckley LJ). As discussed above at pp 377-379 and pp 391-392.

201 See R Dugan, op cit, p 6.

202 Section 4(1).

the agreement is coupled with a flawed asset arrangement, that is, a restriction is placed on the customer withdrawing the funds in the account.[203] Indeed Section 4, being deliberately broad, so as to incorporate a wide range of security interests, would appear to include contractual set-off. There is "a transaction that in substance secures payment or performance of an obligation, without regard to the form of the transaction".[204] This is exactly the reason for the bank and customer entering into a contractual set-off arrangement.

VIII. A Call for Reform

For the reasons already discussed there are compelling reasons to allow the depositary institution taking a security interest in the deposit account of its customer. The arguments to the contrary are based on a misunderstanding of the concepts involved. Nevertheless there is a real uncertainty as to whether or not the *Charge Card Services* line of cases will be followed in New Zealand. Certainty will be restored either upon a definitive judicial ruling by the Court of Appeal of New Zealand or by statutory enanctment. The latter is to be preferred.

There has been a similar call for legislative review of the law following the *Charge Card Services* case in the United Kingdom. The Department of Trade, immediately following the decision, indicated that it would look very favourably on the possibility of legislating to reverse the decision.[205] Likewise the Jack Report, in making various recommendations on the review of areas of banking services law, having noted the unsatisfactory state of affairs following *Charge Card Services*, recommended:[206]

> The Government should institute a process of consultation with a view to introducing legislation to clarify the right of set-off, and the validity of a charge over a credit balance in favour of a person with whom the balance is owed.

It appears that the British Government are either still considering, or have not considered, this recommendation, at least insofar as it applied to charge-backs.

Perhaps due to the misunderstanding that a bank has adequate "security" over its a customer's deposits under its rights of combination, set-off and the banker's lien, the law reform agencies in New Zealand have shown no intention of clarifying the issue of the efficacy of security interests over the bank's own indebtedness. The ideal opportunity has presented itself with the reform process under way in respect of security transactions in personal property. Instead, the Law Commission's proposed draft PPSA clarifies nothing in respect of the position of secured deposit account financing generally. For instance, issues of priority as between a secured third party's rights and the bank's right to statutory set-off have not been addressed; while uncertainties arise from the broad definition of security interests: will contractual set-off qualify as a security interest? Furthermore the rules in relation to pledges of certificates of deposits leaves notification to third parties of the security interest thereby created in an unfortunate position. These issues can be easily clarified by careful consideration of the practical difficulties that

203 The same issue is raised by R Dugan, op cit, p 6.

204 Section 4(1).

205 See the comments of R Youard in "Preferences - Running Accounts", from *Banking Law and Practice 1987*, p 169.

206 *Review Committee on Banking Services Law, (Jack Report), Banking Services: Law and Practice*, § 14(3), and see also ¶ 14.20.

arise in obtaining security over deposit accounts and the policy issues involved in relation to priorites.

If *Re Charge Card Services Ltd* is followed in New Zealand, and it is also held that the bank cannot have a pledge over a negotiable instrument issued by it to its customer,[207] the depositary institution will be left in a quandary. The bank will be unable to obtain a security interest over the deposit without going through an elaborate procedure of having the advance to the customer made by another member of the institution's banking group. Of course, this problem is obviated if a contractual right to set-off qualifies as a security interest. If set-off is regarded as falling within the scope of the draft Act an anomaly results. There is no reason why set-off should qualify while charge-backs do not, as they both effectively secure the bank's own indebtedness to its customer. Furthermore the bank will lose the greatest priority possible - in obtaining a possessory security interest.[208] There are no policy reasons why this situation should result. Meanwhile, if contractual set-off is not regarded as fitting within the definition of security interest, then the bank will be left to those "unsecured" rights along with its rights under a banker's lien. Priority disputes will therefore be inevitable between the banks and third parties with security interests over the deposit. Uncertainty will arise at least until the matter is authoritatively decided.

The philosophies of certainty and uniformity, which underlie the Law Commission's proposal, are undermined by the lack of adequate provisions on deposit account financing. A satisfactory result can be achieved by explicitly providing for security interests, by way of charge-backs and pledges over negotiable instruments issued by banks to their customers. Contractual rights to set-off should be excluded from the definition of security interest, just as a banker's lien has been excluded. The treatment of set-off as against a security interest in terms of priority would then become less problematic. If the bank can obtain a security interest in respect of its own indebtedness there arise policy reasons to subordinate contractual and statutory set-off to such an interest. The same applies in respect of a banker's lien. This would fit neatly within the philosophies underlying the draft Act, and would provide an adequate incentive for banks to perfect a security interest. The only remaining problem would be that in respect of notification of the pledge of a certificate of deposit to third parties. This could be adequately provided for by requiring that for perfection of a possessory security interest in a negotiable instrument the collateral must not be represented in any other form. If it is represented in another form, such as an amount in a deposit account, then perfection is complete on possession of the negotiable instrument *and* by the filing of a financing statement under Section 19 of the draft Act. Effectively all that is needed is an exception to the perfection by possession rule.[209]

IX. Conclusion

The ability of a bank to obtain a security interest over its customer's deposit account has been put into doubt by a trilogy of cases.[210] All the decisions are based on the misunderstanding of obiter dicta remarks made in the English

207 For the reasons advanced by Goode see n 165 and accompanying text.

208 See R Dugan, op cit, p 6.

209 Section 18.

210 *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40; *Estate Planning Associates v Commissioner of Stamp Duties* (1985) NSWLR 495; and *Re Charge Card Services Ltd* [1986] 3 All ER 289.

Court of Appeal in *Halesowen Presswork v Westminster Bank.*[211] While all reasons advanced by those supporting this line of cases can be countered, there is an uncertainty as to the current state of the law. There has been no indication as to which approach the New Zealand courts will take. This is a totally unsatisfactory state of affairs. Logic and strong policy reasons weigh heavily in favour of the legitimacy of the bank to perfect a "security interest" over its customer's deposit accounts. There is no justification for a distinction to be made between the bank and a third party in respect of an ability to obtain a security interest over such collateral.

The uncertainty in this aspect of the law has prompted calls for reform in the United Kingdom[212] and the Unted States.[213] Such a call for reform is now being made in New Zealand.[214] The ideal time presents itself. Secured transactions are currently the subject of reform in New Zealand.[215] It is imperative, if the goals of certainty and uniformity espoused by the Law Commission are to be given effect to, that the implications of the proposed legislation on deposit account financing be examined, and timely amendments made to the draft Act. Some recommendations have been included in this paper.

Until this matter has been resolved, banks, as risk-adverse entities, should not be disuaded to attempt to create security interests over their customers' deposit accounts. Millett J, having decided that a charge-back was conceptually impossible, went on to state:[216]

> It does not, of course, follow that an attempt to create an express mortgage or charge of a debt in favour of the debtor would be ineffective to create a security. Equity looks to the substance, not the form; and, while in my judgment this would not create a mortgage or charge, it would no doubt give a right of set-off which would be effective against the creditor's liquidator or trustee in bankruptcy, provided that it did not purport to go beyond what is permitted by s 31 of the [Bankruptcy Act 1914].

X. Postcript

The reader's attention is drawn to the very recent comments of Dillon LJ in *Welsh Development Agency v Export Finance Co.*[217] The judge recorded his discontentment with the view taken by Millett J in *Re Charge Card Services Ltd*[218] that security could not be taken by a person over his or her own indebtedness. Although his comments were admittedly *obiter*, they carry the weight that is due to comments of a senior English Court of Appeal judge. He stated:

> So far as the decision in *re Charge Card Service Limited* is concerned, I have very considerable difficulty with the view expressed by Millett J [at [1986] 3 All ER 289,308] that a book debt due to a company (Charge Card Services Ltd) from Commercial Credit could not be charged in favour of Commercial Credit itself because a charge in favour of a debtor of his own indebtedness to the chargor

211 [1970] 3 All ER 473, 477 (per Lord Denning MR); 487-488 (per Buckley LJ).

212 *Review Committee on Banking Services Law, (Jack Report), Banking Services: Law and Practice*, § 14(3), and see also ¶ 14.20. See nn 205-206 and the accompanying text.

213 See for example L E Zubrow, "Integration of Deposit Account Financing into Article 9: Proposal for Legislative Reform", 68 Minn L Rev 899 (1984).

214 See R Dugan, op cit.

215 See particularly J H Farrar and M A O'Regan, *Reform of Personal Property Security Law*, Law Commission Preliminary Paper No 6 (NZLC PP 6), Government Printing Office, Wellington, 1988; and the New Zealand Law Commission's report, *A Personal Property Securities Act for New Zealand (Report No 8)*.

216 *In Re Charge Card Services Ltd* [1986] 3 All ER 289, 309g.

217 Unreported Court of Appeal (Civil Division), 19 November 1991, noted in *The Financial Times*, 27 November 1991; *The Times*, 28 November 1991

218 [1986] 3 All ER 289

is conceptually impossible. I see no basis for this conclusion in the judgment of Millett J himself. I see no reason why the transaction which took place in *Ex parte Mackay LR* 8 Ch App 643 (better reported in 42 LJ (NS Bankruptcy at 68) and was upheld by this court - viz that a creditor who was entitled to royalties from a debtor but was also indebted to the debtor in a sum by way of loan bearing interest could give bankruptcy of the creditor, to apply half the royalties in reduction of the loan and interest - should not be valid in law. The same applies to the auctioneer's lien on his client's money in his hands which was upheld in *Webb v Smith* 30 ChD 192. However, I do not see that this arises in the present case.

The observations to which we were referred of Lord Denning MR and Buckley LJ in this court and of members of the House of Lords on further appeal in *National Westminster Bank v Halesowen Presswork & Assemblies Ltd* [[1970] 2 All ER 473; [1972] 1 All ER 641] are, in my judgment, directed to a different situation, viz that the so-called banker's lien, where a customer had several accounts with a bank, was more accurately to be described as a right of the banker to combine accounts because there was only one banker and customer relationship, that the banker's right to combine accounts might be suspended by express or implied agreement with the customer but that, on the view which prevailed, an implied agreement to suspend the right automatically came to an end when the customer ceased trading and went into liquidation. None of that has any relevance to the present case.