Claim No HC02 C01138

Neutral Citation Number: [2004] EWHC 1582 (Ch)
IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Before:

TERENCE MOWSCHENSON Q C (sitting as a Deputy High Court Judge)

Between:

(1) MICHAEL BRUCE FRASER
(2) AGATHA SHUK-YEE WONG-FRASER
(3) DAVISON TOOLS LIMITED
(4) SANKEY PRODUCT DEVELOPMENTS LIMITED

Claimants

- and -

(1) OYSTERTEC PLC
(2) PAUL ANTHONY DAVIDSON
(3) ADRIAN PHILIP BINNEY
(4) EASYRAD LIMITED

Defendants

AND

YORKSHIRE BANK PLC

Third Party

DANIEL LIGHTMAN (instructed by Berg & Co) for the First Defendant
MATTHEW PARKER (instructed by Addleshaw Goddard for the Third Party)

Hearing dates: 20th & 21st May 2004

JUDGMENT

Terence Mowschenson Q.C.:

1. This is an application by the First Defendant, Oystertec PLC ("Oystertec") for a final third party debt order ("pursuant to CPR Part 72.2(1) against Yorkshire Bank plc ("the Bank"). An interim third party debt order was made by Master Moncaster on 3rd March 2004 to enable Oystertec to enforce an order that Mr Davidson pay it the sum of £575,000 which it had obtained against him. The order was served on the Bank on or before 9th March 2004. On 7th May 2004 Chief Master Winegarten adjourned the final hearing to be heard by a High Court Judge.

2. Mr Davidson maintains three bank accounts with the Bank; the accounts with their respective balances as at 11 March 2004 are set out below:

   i) Account No 1 (No 68148621): £25,015.32

   ii) Account No 2 (No 6818736): £86,990.01

   iii) Account No 3 (No 69038264): £541.58

3. The Bank contests the making of a final third party debt order on two grounds.

   i) In relation to Account No 1 it claims to have an equitable charge over the chose in action represented by the monies standing to credit of Account No 1; alternatively, if the agreement said to give rise to the equitable charge does not create an equitable charge, i.e., a proprietary interest, on the grounds that it is a charge in favour of the Bank on a chose in action owed by the Bank to Mr Davidson, the agreement constitutes a flawed asset arrangement which would have had contractual effect to prevent Mr Davidson obtaining the monies and Oystertec cannot be in a better position that Mr Davidson in relation to the monies in Account No 1.

   ii) In relation to all three Accounts it claims that it had a right of set off as at the date of service of the order (on or before 9th March 2004) of the order of Master Moncaster in respect of the sum of £147,232.26 due from Mr Davidson to the Bank under a loan facility dated 7th August 2003.

4. In the event that that I found either or both of the grounds set out above made out, the Bank contends that I should not exercise my discretion in favour of making the final order but should discharge the interim order.

5. Before embarking on the particular facts of this matter I should note briefly the manner in which an interim third party debt order operates. The making of an interim third party debt order creates an equitable charge on the debt: see Farwell LJ in Galbraith v Grimshaw [1910] 1 KB 339 and Joachimson v Swiss Bank Corp [1921] 3 KB 110 at 131 per Atkin LJ. Accordingly the interim third party debt order does not afford priority over a prior equitable charge; a court would not (other things being equal) exercise its discretion to make an interim order into a final order in circumstances where there was a prior equitable charge.

6. Where a Bank resists a final order on the ground that it has a right of set off, the Bank may dispute liability on that ground. In the past the courts have been concerned with cases where a Bank or garnishee (now third party) has attempted to set off debts accruing due after the date of the interim order against monies owed to the judgment debtor: see Tapp v Jones (1875) LR 10 QB 591 where Blackburn stated at p.593:

> I agree that no greater right is given to the creditor than the debtor had. It is obviously just that if a cross debt were due to the garnishee at the date of the attachment there should be a right of set-off in his favour, and I should strive hard to give effect to it if I could, though there would be difficulties in the way. But Mr. Williams goes further, and maintains the right to set off debts accruing after the attachment. For this I see no ground. On the attachment the thing is absolutely fixed; and there is no clause of mutual credit or set-off. What would have been wise or just I do not say; but the legislature has certainly said no such thing as that contended for.

It is not clear whether the reference to debts "accruing" due is a reference to debts pursuant to contracts entered into before service of the interim order or to contracts entered into after service of an interim order.

Was Account No 1 charged to the Bank or the subject of a flawed asset arrangement?

7. The evidence from the Bank was contained in three witness statements. The first that of Mr Robert Payne a solicitor with the Bank's solicitors and two witness statements of Mr Paul Nielsen ("Mr Nielsen") a Senior Business Manager at the Manchester Regional Business Centre of the Bank. Mr Nielsen was able to give first hand evidence of matters as he had been involved in the opening of Account No 1. His evidence was to the effect that the sum of £25,000 was deposited in Account No 1 by Mr Davidson specifically in support of a guarantee executed by Mr Davidson dated 22nd April 2003 in favour of the indebtedness of a third party customer of the Bank. The Bank did not identify the customer due to reasons of bank confidentiality. A copy of the guarantee was exhibited to Mr Payne's witness statement. Mr Nielsen stated that albeit that Account No 1 was not referred to in the guarantee, there was an agreement with Mr Davidson to the effect that monies (i.e., the monies standing to the credit of Account No 1) would be deposited by Mr Davidson to be held as specific security for Mr Davidson's liability under the guarantee, that the amount to be drawn down under the

third party facility would be limited to the monies deposited in Account No 1 and that Mr Davidson could not draw on Account No 1 whilst there was a liability on the guarantee. I shall not set out all of the evidence given by Mr Nielsen but it was relatively detailed albeit supported by very little contemporary documentary evidence.

8. The agreement with Mr Davidson was not in writing; nor had the Bank made any notes or meeting recording the agreement. It did produce a document dated 27th May 2003 relating to the third party facility which was endorsed in manuscript with the following "Reduced O/D pending receipt of £25,000 additional monies by PD". In addition the Bank statements for Account No 1 recorded that after credit of the initial £25,000, there had been no movement on the account other than the crediting of interest.

9. Mr Lightman urged me to reject the Bank's evidence as to the alleged agreement. He pointed out the dearth of contemporary written material to evidence the agreement. He also pointed to the guarantee which contained a provision for the maintenance of a set off credit balance to be maintained; the provision had been struck through. The set off credit balance mechanism referred to in the guarantee provided for a specified balance to be kept in an account to be available to be set off against monies owed under the guarantee. Mr Nielsen stated in his 2nd witness statement that he had dealt with Mr Davidson on a number of occasions and Mr Davidson had not used the set-off route mechanism provided in the guarantee but preferred an arrangement outside the terms of the guarantee.

10. Mr Lightman - quite rightly - made much of the dearth of contemporary documentation and the rather careless manner in which the Bank operated. Notwithstanding the lack of written supporting material I find that the Bank had entered into an agreement on the terms described by Mr Nielson.

11. In my determination the agreement amounted to an equitable charge: see In re Bank of Credit and Commerce [1998] AC 214 at p.226 and following where Lord Hoffmann refers to certain of the characteristics of an equitable charge:

> I think one needs to identify the normal characteristics of an equitable charge and then ask to what extent they would be inconsistent with a situation in which the property charged consisted of a debt owed by the beneficiary of the charge. There are several well known descriptions of an equitable charge (see, for example, that of Atkin L.J. in National Provincial and Union Bank of England v. Charnley [1924] 1 K.B. 431, 449-450) but none of them purports to be exhaustive. Nor do I intend to provide one. An equitable charge is a species of charge, which is a proprietary interest granted by way of security. Proprietary interests confer rights in rem which, subject to questions of registration and the equitable doctrine of purchaser for value without notice, will be binding upon third parties and unaffected by the insolvency of the owner of the property charged. A proprietary interest provided by way of security entitles the holder to resort to the property only for the purpose of satisfying some liability due to him (whether from the person providing the security or a third party) and, whatever

> the form of the transaction, the owner of the property retains an equity of redemption to have the property restored to him when the liability has been discharged. The method by which the holder of the security will resort to the property will ordinarily involve its sale or, more rarely, the extinction of the equity of redemption by foreclosure. A charge is a security interest created without any transfer of title or possession to the beneficiary. An equitable charge can be created by an informal transaction for value (legal charges may require a deed or registration or both) and over any kind of property (equitable as well as legal) but is subject to the doctrine of purchaser for value without notice applicable to all equitable interests.

He also, obiter, made it clear that in his judgment there was no reason why a bank could not take a charge over a credit balance on an account maintained with itself: see pages 227 and following. All the other members of the House of Lords agreed with his judgment. I was urged by Mr Lightman to look at the dissent by Professor Sir Roy Goode in his book Legal Problems of Credit and Security 3rd Edition. However, as I read the passage at para 3-12, Sir Roy Goode recognises that the argument against the concept is now over as it must "yield to business practice and legislative developments designed to accommodate it".

12. If I am wrong that the agreement amounted to an equitable charge, I hold that it produced a contractual restriction on seeking payment of the monies until liability under the guarantee had been discharged, commonly called a flawed asset arrangement.

13. In addition to the ground set out above, the Bank relied upon a contractual right of set off contained in a facility ("the facility") in the sum of £150,000 for 15 years granted to Mr Davidson on 7th August 2003. The facility was granted to refinance a property called United House, Tenax Circle, Trafford Park, Manchester ("the Property").

14. As at the date of the receipt of the interim order (sometime on or before 9th March 2003) the Bank had not demanded repayment of the monies due on the facility; i.e. the monies due under the facility were not due and payable when the Bank received the interim order. It made a demand for repayment of the monies due under the facility on 11th March 2004 after receipt of the interim order.

15. In order to rely upon the right of set off as a ground for persuading me not to order that the interim order become a final order the Bank submitted that the right of set off in clause 14.4 permitted it to set off amounts standing to the credit of the Accounts at a time when Mr Davidson's debt under the facility was not due and payable because a demand had not been made (even though a condition permitting a demand to be made had occurred unknown to the Bank); and (ii), if clause 14.4 had that effect I should exercise my discretion against making the order final notwithstanding that the Bank had not in fact exercised the right of set off prior to receipt of the interim order.

Did clause 14.4 provide for a set off of amounts on a credit balance at a time when the sum owed was not due and payable?

16. In clause 7 the facility provided:

    7.1 We may demand repayment of all sums owed by you to us pursuant to the terms of this letter, including interest and charges, if any of the events referred to in the Appendix to this letter occurs.

    7.2 On any such demand, all sums owed by you to us pursuant to the terms of this letter, including interest and charges, will become immediately due and payable and we may enforce any security which we hold.

    In clause 14.4 of the facility under the heading "other terms and conditions applicable to the facility" the facility provided:

    > We may at any time set off any credit balances on any account you have with us against any sum you may owe to us from time to time

    It is well established that absent an express agreement a banker has no implied right to combine or set off the amount due under a facility (during its currency) with amounts standing to the credit of a debtors account: see National Westminster Bank v Halesowen Presswork [1972] AC 785 at p.809 per Lord Cross:

    > If a banker permits his customer to have two accounts, one - sometimes called a "loan account" - which records the indebtedness of the customer to the bank in respect of advances made to him and the other a current account which the customer keeps in credit and uses for the purpose of his trade or business or ordinary expenditure, then, unless the bank makes it clear to the customer that it is retaining the right at any moment to apply the credit balance on the current account in reduction of the debt on the loan account, it will be an implied term of the arrangement that the bank will not, so long as it lasts, consolidate the two accounts. As Scrufton L.J. pointed out in Bradford Old Bank Ltd. v. Sutcliffe [1918] 2 K.B. 833, 847, unless such a term is implied no customer could feel any security in drawing a cheque on his current account if he had a loan account greater than the credit balance on his current account.

17. Accordingly absent clause 14.4 the Bank would not have had the right to set off amounts due on the facility which had been demanded against the Accounts without notice. That is one reason why clause 14.4 was included in the facility.

18. It is noteworthy that the expression "owe" is used in clause 7.1 of the facility as referring to indebtedness, albeit not being due and payable, since the expression is used in respect of indebtedness which is not due and payable but which will become due and payable upon the demand being made. In clause 7.2 it is used in relation to indebtedness which has been the subject of a demand and is due and payable.

Paragraph 14.4 refers to the right to set off "at any time" any credit balance on any account "against any sum you may owe to us from time to time". I consider that if the Bank wanted to obtain a right to set off amounts due on the facility prior to demanding repayment on the facility it should have used clearer language to achieve its objective. If the Bank is correct Mr Davidson could have found his ability to write cheques on the Accounts withdrawn without any notice at all. I consider that the expression "owe" in paragraph 14.4 is used in a sense of being due and payable and that a demand was a prerequisite for a set off under Rule 14.4.

19. Accordingly as at the date of service of the interim order the monies due under the facility were not due and owing.

Exercise of discretion

20. CPR 72.2 confers discretion upon the court whether to make a final third party debt order. Some guidance as to the manner in which the court should exercise its discretion is to be found in the cases: see for example Roberts Petroleum Ltd v Bernard Kenny [1982] 1 WLR 301. A prior proprietary interest will be recognised. A right of set off in relation to a debt owing to the judgment debtor will be recognised as will an unliquidated cross claim: see Hale v Victoria Plumbing Limited [1966] 2 QB 746.

21. In relation to Account No 1, I take into account the fact that Account 1 was subject to an equitable charge in favour of the Bank. If the agreement did not constitute an equitable charge but only a flawed asset arrangement, the effect of the arrangement is that the monies standing to the credit do not constitute a debt "being due or accruing due" within CPR 72.2. Until the guarantee is discharged the monies on Account 1 will not be payable to Mr Davidson or to his order. Accordingly I decline to make a final order in relation to the monies standing to the credit of Account 1.

22. In relation to the monies standing to the credit of Accounts 2 and 3, I consider that it would be unjust to make the order for a number of reasons.

    i) The Bank lent Mr Davidson substantial monies, of which over £147,000 was outstanding prior to the service of the interim order, on terms that it was entitled to set off the amount owed in respect of the facility (after demand) in relation to monies standing to the credit of the Accounts. Accordingly, as at the date of service of the interim order, the Accounts were subject to a contractual term of set off permitting set off in relation to indebtedness on the facility subject only to the making of a demand. The making of the interim order was an event which entitled the Bank to demand payment but occurred without notification to the Bank.

    ii) Had Oystertec taken an assignment of the Accounts it would have been subject to that contractual term affecting the Accounts. It is difficult to see why Oystertec should be in a better position in relation to recovery of the monies

standing to the credit of the Accounts than Mr Davidson; in my judgment it should not be.

iii) I do not consider that the fact that the Bank has alternative security, a charge on the Property, militates in favour of making a final order. The set off is plainly an easier and more certain route for the Bank to take in order to recover its monies. It had taken the benefit of the rights of set off in addition to a charge over the Property and I can see no reason to deprive it of the benefit afforded by those contractual rights. I also do not consider that the careless manner in which the Bank conducted its affairs should lead me to make the interim third party debt order into a final order.

23. The matters set out in relation to Accounts No 2 and 3 also apply to Account No 1. However for the reasons set out above I decline to make a final third party debt order in relation to Account No 1.

24. In the light of the above I do not consider it appropriate to exercise my discretion in favour of making the final payment order.