THE CONCEPT OF "CHARGE" IN THE LAW OF CHATTEL SECURITIES

The interrelation and operation of the Chattels Transfer Act 1924 and the Companies Act 1955 with respect to transactions creating security interests in the assets of incorporated companies is a subject of considerable complexity. A key concept in this area is the "charge". This article attempts to answer the question — what is a "charge" and how is it to be distinguished from other secured transactions?

I. INTRODUCTION

One of the major difficulties with the current law in New Zealand governing the taking of security over personal property, apart from the fact that the legislation "bristles with inconsistencies, contradictory or outmoded policies, and haunting obscurities",[1] is the necessity to be forever distinguishing the various forms of security device, especially those which express essentially the same transaction. The basis of our system of secured transactions is conceptual — transactions are regulated according to their form rather than their substance and function.[2] The rights and remedies of both parties, the position of third parties, whether the security is subject to registration requirements and the consequences (if any) of non-registration, all depend on the form of the security device chosen and this can often lead to irrational results. The necessity to understand and implement these conceptual distinctions, when coupled with the different rules which apply depending on the legal personality of the debtor (company or individual) and the method of expression of the transaction (written or oral), not to mention the obscurities in the present legislation, make the field of secured transactions one of the most demanding for the student of commercial law.

Typical of the sort of distinctions which must be drawn is that between the "charge" and other security devices. It is apparent from

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1. Riesenfeld, *The Quagmire of Chattels Securities in New Zealand* (1970), 15.
2. Unless, of course, there is proof that the form does not represent the parties' actual common intention. Recent cases have finally recognised that, since the law makes available different forms in which parties may choose to express their transactions, the argument that a security document is a "sham" must be rejected so long as the parties, in effect, "do what they say they are doing". See *Bateman Television Ltd.* v. *Coleridge Finance Co. Ltd.* [1969] N.Z.L.R. 794 and *Paintin and Nottingham Ltd.* v. *Miller, Gale and Winter* [1971] N.Z.L.R. 164.

the provisions of the Chattels Transfer Act 1924 and the Companies Act 1955 that this term is used in its technical sense and that the distinction can in some cases determine whether a particular security requires registration, the place of registration (if it is required) and the consequences of non-registration.

The term "charge" does not appear in the general part of the definition of "instrument" in s. 2 of the Chattels Transfer Act, but it is caught by inclusion (f) which refers to

> "any agreement . . . by which a right in equity to any chattels or to any *charge* or security thereon or thereover is conferred."

However, later on in s. 2, exclusion (j) operates to delete from the definition of instrument:

> "Mortgages or charges granted or created by a company incorporated or registered under the Companies Act 1955."

It is clear from these provisions that charges over chattels granted by individuals are instruments and that, unless para (i)[3] or one of the other exclusions[4] applies, company securities over chattels which are not mortgages or charges are subject to the Chattels Transfer Act.

It is even more important to distinguish between charges and other securities in the context of the registration provisions of the Companies Act 1955 (ss. 102 and 103). Only the nine types of *charge* (which includes "mortgage") outlined in s. 102(2) require registration under the Companies Act. A security granted by a company which is not a charge or mortgage is either governed by the Chattels Transfer Act or does not require registration at all.[5]

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3. Para. (i) refers to "debentures . . . issued by any company . . . and secured upon the capital stock or chattels of such company . . . " The exact width of this exclusion, which was first enacted in the Chattels Transfer Act 1889, puzzled the Courts early on (see Riesenfeld, note 1, at pp. 15-19) and ultimately led to the enactment of the registration provisions of the Companies Act and the exemption of company mortgages and charges from the Chattels Transfer Act; see Companies Amendment Act 1900 (s. 9) and the Chattels Transfer Amendment Act 1919 (s. 3). These provisions solved the major problems and para. (i) has not since arisen for consideration. However, as the word "debenture" has been defined widely as "a document which either creates a debt or acknowledges it" (*Levy* v. *Abercorris Slate & Slab Co.* (1887) 37 Ch.D. 260, 264 per Chitty J.), para. (i) remains a significant exclusion and would seem to cover all written securities for debts granted by a company over its chattels. Transactions clearly not within this exclusion would be all instruments by way of bailment (conditional sale, hire purchase and lease agreements), whether or not the company is grantor or grantee, and absolute assignments of book debts.
4. E.g. para. (h) which was invoked in *Re Hamilton Young & Co.* [1905] 2 K.B. 772.
5. In addition, of course, a security which is a charge but is not one of the nine types mentioned in s. 102(2) will not be caught by either Act, e.g. the charges over Government and Local Body stock in *Automobile Association (Canterbury) Incorporated* v. *Australasian Secured Deposits Ltd.* [1973] 1 N.Z.L.R. 417.

What then is a "charge" and how is it to be distinguished from other securities? An answer to this question, which is obviously the key to the operation of the Chattels Transfer Act and Companies Act in relation to company securities, is rather clearer since the Court of Appeal's decisions in *Paintin and Nottingham Ltd.* v. *Miller Gale and Winter*[6] and *Waitomo Wools (N.Z.) Ltd.* v. *Nelsons (N.Z.) Ltd.*[7] However, areas of uncertainty still remain, largely because some fundamental property concepts have not been fully appreciated.

This article is an attempt to explain the charge and resolve these areas of uncertainty. In order to do this, the first task must be to classify and explain the major forms of secured transactions, for it is only then that the distinct legal nature and characteristics of the charge can be fully grasped.

II. THE CATEGORIES OF SECURED TRANSACTIONS

The writer's main concern is with *consensual* secured transactions, i.e. those created by agreement between the parties as opposed to those arising by operation of law. The latter, of which the common law possessory, statutory and equitable liens are the most commonly encountered, are, of course, not subject to the registration provisions of the Chattels Transfer and Companies Acts.[8]

Possessory and Non-possessory Securities

Consensual secured transactions can usefully be divided into the two broad categories of possessory and non-possessory securities. The possessory securities are the pledge and *contractual* possessory lien. The basic non-possessory securities are the chattel mortgage, the instruments by way of bailment (conditional sale, hire purchase and lease agreements) and the equitable charge. Each of the transactions within the two broad[9] categories is conceptually distinct from the

6. [1971] N.Z.L.R. 164.
7. [1974] 1 N.Z.L.R. 484.
8. With regard to the Companies Act, see *London and Cheshire Insurance Co. Ltd.* v. *Laplagrene Property Co. Ltd.* [1971] Ch. 499.
9. These categories are not intended to be all-embracing. The absolute assignment of book debts, for example, although a sale and therefore conceptually distinct from the assignment by way of mortgage, is essentially a secured financing transaction. Certain legal consequences do flow from the choice of form, but for most practical purposes the obligations of the parties under both are the same. Often the only difference between the two forms is that the assignment by way of mortgage contains the qualifying words "by way of mortgage only". The latter in theory gives a right of redemption but in practice neither party envisages that the debt will be reassigned. The assignment by way of mortgage is the most common form in New Zealand. However, the reasons for this are that it is not liable for stamp duty and, in the case of customary hire purchase agreements, is exempt from the Moneylenders Act 1908 and the Chattels Transfer and Companies Act, rather than assignors wishing to reserve a right to redeem.

others. They have developed independently and are governed by different rules of law. In cases where it is doubtful which form of security has been created, the court must seek to ascertain the intention of the parties from an interpretation of the security document in light of all the surrounding circumstances.[10]

Non-Possessory Securities — The Chattel Mortgage

The chattel mortgage has the effect of transferring the debtor's title/ownership, whether legal or equitable, to the creditor subject to the debtor's equity of redemption and contractual right to retain possession. The essence of the mortgagee's security is his title to the chattel. The legal mortgage is the most common and requires little explanation. There are two classes of equitable mortgage.[11] First, the equitable mortgage of legal property which arises where there has been an express contract to create a legal mortgage[12] or an informal attempt to create a legal mortgage.[13] Secondly, there is the equitable mortgage of an equitable interest. Examples are the second mortgage (the mortgage of the equity of redemption), the mortgage of one's equitable interest in a chattel held in trust and the mortgage of future chattels.[14]

Some writers[15] have distinguished the mortgage from other securities on the ground that it alone involves the transfer of proprietary rights but, as Sykes point out,[16] this does not serve as an adequate basis of characterisation because

> "all securities pre-suppose some proprietary right, though not necessarily an ownership right, in the holder of the security."

In his view, the distinguishing feature of the common law concept of mortgage is that the mortgagor "transfers all he has" — "he parts with his full armoury of ownership rights".[17] However, taking into

10. See, e.g., *Sewell* v. *Burdick* (1884) 10 App. Cas. 74, esp. 95-97, where the question was whether the transaction was a mortgage or pledge.
11. See generally, Sykes, *The Law of Securities* (2nd ed. 1973) 112-131, 446-451.
12. As in, e.g., *New Zealand Serpentine Co. Ltd.* v. *Hoon Hay Quarries Ltd.* [1925] N.Z.L.R. 73.
13. E.g., a company mortgage not executed under seal.
14. An example of the latter, although not a typical one, is the agreement in *Carncross* v. *Wilson's Motor Supplies Ltd.* [1924] N.Z.L.R. 327. The agreement was essentially a conveyance of future chattels by way of security conferring, in addition, a power to seize in the event of default. Cf. the doubts expressed by Riesenfeld, note 1, at p. 19.
15. Waldock, *The Law of Mortgages* (2nd ed. 1950) 4; Fisher & Lightwood, *The Law of Mortgages* (8th ed. 1969) 3.
16. Note 11, at p. 12.
17. Sykes, note 11, at p. 14. As Sykes states (p. 6), "when a person has ownership of a *res* he has a collection or aggregation of rights *in re*, such as the rights of possession and of enjoyment and the right of transfer or disposal of the *res* . . . The owner may divest himself of the right of possession and the right of enjoyment, but even such divesting . . . leave[s] him some residue, the kernel of which is probably to be found in the right of disposition, the right of transferring or "willing" away what is one's own."

account the intervention of equity and its conferral of proprietary rights on the mortgagor, he later states that[18]

> "the true view seems to be that the rights, powers and liberties which go to make up that phenomenon called "ownership" are divided between the two parties and that such division is accomplished by the mere fact of the existence of the security."

The essence then of the mortgage is that it operates immediately as a "splitting or division of ownership rights", a description which covers the equitable mortgage as well.[19]

Instruments by way of bailment

The principal examples of this category are the conditional sale and hire purchase agreements and, more recently, consumer and business equipment leases. They differ in legal form from other secured transactions in that, instead of the debtor granting an interest in his own property to his creditor, they involve the debtor *acquiring* an interest. It is the *creditor* who is the grantor of the instrument and the immediate interest granted to the debtor is the right to possession whilst ownership is *retained*. The chattel mortgage, for example, on the other hand, involves the debtor granting ownership to the creditor whilst retaining the right to possession.

Possessory Securities — The Pledge[20]

The pledge is a transaction whereby possession of goods or, in some cases, "documents of title" to goods,[20a] is delivered to the creditor by way of security. Although the creditor's security is his possession of the goods and general ownership remains in the debtor, he does receive what is usually termed a "special property" which enables him to sell the goods in the event of default.[21] The pledgee/creditor has an assignable interest in the property unless the parties' contract expressly stipulates to the contrary.[22] However, once possession is redelivered to the pledgor, unless for a limited or specific purpose,[23] the pledgee's rights are lost.

The pledge is obviously a conceptually distinct transaction from the chattel mortgage and this has often been emphasised by the

18. Ibid., at p. 824.
19. Ibid., at p. 158.
20. See generally Sykes, note 11, at pp. 546-550 and Garrow & Gray, *Law of Personal Property in New Zealand* (5th ed. 1968), 76-81.
20a. Mercantile Law Act 1908, s. 4.
21. *Ryall* v. *Rowles* (1749) 1 Ves. Sen. 349, 359, 27 E.R. 1074, 1081; *Re Morritt* (1886) 18 Q.B.D. 222, 232, 234.
22. *Donald* v. *Suckling* (1866) L.R. 1 Q.B. 585, 608, 615.
23. See *North Western Bank* v. *John Poynter, Son, & MacDonalds* [1895] A.C. 56 and *Official Assignee of Madras* v. *Mercantile Bank of India Ltd.* [1935] A.C. 53, 64.

courts.[24] In the case of the mortgage there is a transfer of ownership but no delivery of possession, whereas the pledge is the opposite. As stated by Sykes,[25] the pledge differs from the mortgage (as originally conceived) in that

> "the debtor does not part with his full armoury of ownership rights at all; he merely parts with one right in that armoury, viz. the right of possessing."

If, however, on a broader view, it is now more accurate, taking into account the mortgagor's beneficial ownership and equitable proprietary rights, to regard the mortgage as itself involving a division of ownership rights, the essential difference is that, in the case of the pledge, "only one of the ownership rights, viz. that of possession, passes to the creditor . . . "[26].

The Possessory Lien

The possessory lien is a true possessory security in that normally the creditor's right is a mere right to detain his debtor's goods until his claim is satisfied, without a power of sale or an assignable interest.[27]

It has been doubted, however, whether there is such a security as the contractual possessory lien. Traditionally, the possessory lien has been regarded as arising by operation of law only. Thus, in the early case of *Gladstone* v. *Birley*[28] Grant M.R. observed that

> "it is usual to speak of lien by contract, though that be more in the nature of an agreement for a pledge."

The same view is adopted by Halsbury,[29] Garrow and Gray,[30] and Sykes,[31] although the latter in another context observes that "an 'agreement for a lien' is indistinguishable from an equitable charge."[32] Waldock, on the other hand, states that "a right analogous to a possessory lien may . . . be created by the contract, and it is usual to include such rights under the description of lien."[33]

The latter is clearly the better view. There is no reason in principle why parties cannot agree upon a security which is to consist merely of a right to retain possession. Certainly, the Court of Appeal in *Waitomo Wools (N.Z.) Ltd.* v. *Nelsons (N.Z.) Ltd.*[34] never doubted that this was so. The agreement in that case, which will be discussed further later, merely conferred a right to retain possession and it did

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24. See authorities, note 20, and also *Halliday* v. *Holgate* (1868) L.R. 3 Ex. 299, 302, and *Ex parte Hubbard* (1886) 17 Q.B.D. 690, 698.
25. Note 11, at p. 14.
26. Ibid., at p. 825.
27. *Donald* v. *Suckling* (1866) L.R. 1 Q.B. 585, 604.
28. (1817) 2 Mer. 401, 404, 35 E.R. 993, 994.
29. *24 Halsbury's Laws of England* (3rd ed.) 144.
30. Note 20, at p. 162n.
31. Note 11, at p. 550.
32. Ibid., at p. 160.
33. Note 15, at p. 8.
34. [1974] 1 N.Z.L.R. 484.

not occur to anyone to suggest that, in law, it created a pledge. In each case it will be a question for the Court to determine the intention of the parties. In the *Waitomo Wools* case a possessory lien was clearly all that was envisaged because the agreement was expressed as a right to retain goods on which work was to be done. In other contexts, it might well be appropriate for the Court to regard an "agreement for a lien" as in fact creating a pledge. This would be so where possession of property was handed over as security for a loan, especially if, in addition, the agreement conferred a right to sell. Alternatively, where there is no delivery of possession, actual or contemplated, the "agreement for a lien", as Sykes suggests, should be regarded as creating an equitable charge.

The earlier comments with respect to the pledge/mortgage distinction apply, of course, *a fortiori* to the contractual possessory lien. Clearly also both transactions are conceptually distinct from other instruments by way of bailment. Where there is a contractual possessory lien or pledge the debtor delivers possession and retains general ownership. In the case of conditional sale, hire purchase and lease agreements, the *creditor* delivers possession and retains ownership.

III. THE EQUITABLE CHARGE

Having considered, albeit briefly, the essential features of and distinctions between the other principal securities, it is now possible to explain the 'charge'. It will be seen that it is an entirely different form of security transaction.

An equitable charge, otherwise commonly known as an "hypothecation",[35] is a security whereby "without any transfer of, or agreement to transfer, ownership or possession, property is appropriated to the discharge of a debt or some other burden."[36] Since the common law courts recognised only two kinds of security interest in personal property — those based on absolute ownership/title and possession — a charge at law conferred no proprietary rights and the creditor had only a personal action in contract. Equity intervened, however, and gave the chargee a right to have the property applied to the satisfaction of the debt in preference to all subsequent claimants except, of course, the bona fide purchaser for value of the legal title without notice.[37]

The essence of the charge then is that it is a mere encumbrance attaching to the property and does not convey any recognised ownership interest to the creditor. A charge on personal chattels, for example, not

35. The terms are often used interchangeably by Sykes. See also Holden, *Law and Practice of Banking* (5th ed. 1970) ii, 268.
36. Cheshire, *Modern Law of Real Property* (11th ed. 1972) 635. For similar definitions, see Waldock, note 15, at pp. 9-10; Fisher & Lightwood, note 15, at pp. 4, 21, *4 Halsbury's Laws of England* (4th ed.) paras. 604 and 649 and Fairest, *Mortgages* (1975) 19.
37. See generally *Mathews* v. *Goodday* (1861) 31 L.J. Ch. 282.

being an assurance of property, could not be a bill of sale/instrument without the express statutory inclusion mentioned earlier. The remedies of the chargee in the event of default, unless contract[38] or statute add others, are application to the court for a sale order (which order is of right and not discretionary) or the appointment of a receiver.[39] Historically, the charge gave no right to take possession or foreclose the debtor's interest.

No special form of words is necessary to create a valid equitable charge. The transaction will usually be expressed either in the form of an immediate grant ("I hereby charge") or an agreement to grant ("I agree to charge").[40] The floating charge, for instance, the most common equitable charge albeit one having its own special features, is usually expressed as a "charge" on the whole of the company's undertaking and assets. However, transactions expressed as "charges" are not the only equitable charges. Thus, in *Brown* v. *Bateman*,[41] a contractual term which gave the owner of land power to prevent the removal of his builder's materials from the land was held to have created a proprietary interest in the owner's favour amounting to an equitable charge. In addition, the banker's "letter of hypothecation", which usually states that goods are held "on your account and under lien to you" or are "hereby hypothecated", creates a valid equitable charge.[42]

The above transactions must, however, be distinguished from another whereby a creditor is merely given a right to seize his debtor's chattels and sell them to satisfy his claim. This "licence to seize", which is sometimes inserted in instruments as a means of attaching the debtor's after-acquired property,[43] is not a charge because it does not confer a proprietary interest. The grantee merely receives a personal right of seizure which is terminated on bankruptcy.[44]

It seems, therefore, that although the situations cannot be precisely defined, an equitable charge will have been created where the intention is to confer a right to resort to property in the event of default to satisfy the creditor's claim, other than by way of transfer of the debtor's ownership or possession or conferral of a right to take possession. In many respects, the equitable charge is the law of securities' "rag-bag", catching as it does transactions involving something less than the transfer of ownership or possession but something more than the mere licence to seize.

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38. E.g. the company's lien over shares, which is essentially an equitable charge because it arises out of contract, usually enables the company to sell without application to the court.
39. *Mathews* v. *Goodday*, note 37; *Tennant* v. *Trenchard* (1869) L.R. 4 Ch. App. 537; *In re Owen* [1894] 3 Ch. 220.
40. See generally Sykes, note 11, at pp. 155-158.
41. (1867) L.R. 2 C.P. 272.
42. See *In re Hamilton Young & Co.* [1905] 2 K.B. 772; *O.A. of Madras* v. *Mercantile Bank of India Ltd.* [1935] A.C. 53, 65; and *Ladenburg & Co.* v. *Goodwin, Ferriera & Co. Ltd.* [1912] 3 K.B. 275.
43. E.g. in *Re Franks* [1934] N.Z.L.R. 886.
44. *Reeve* v. *Whitmore* (1863) 33 L.J. Ch. 63, 66; *Thompson* v. *Cohen* (1872) 7 L.R. Q.B. 527; *In re Lind* [1915] 2 Ch. 345, 361-362.

The Charge/Mortgage Distinction

Although they have occasionally been confused,[45] the charge is clearly a conceptually distinct transaction from the mortgage and this has often been emphasised in various contexts by the courts.[46] In the case of a charge, there is no transfer or division of ownership rights. It is merely an encumbrance attaching to the property giving the creditor, on default, a right to resort to that property to satisfy his claim, normally by applying to the court for a judicial sale.

The distinction has been best explained by Sykes.[47] The mortgage operates to transfer existing rights to the creditor whereas the charge transfers none of these rights. The chargee gets nothing entitling him in any sense to call the property his own — he has no "actual *enjoyment* rights". Certain proprietary rights are *created*, but these rights "are potential only and are not available for exercise until there has been default."[48] The charge is merely a "shadow, . . . cast by the debt upon the property of the debtor"[48a] which immediately vanishes on repayment. As a result, the chargor, strictly speaking, has no equity of redemption. Having parted with nothing there is nothing to be restored, whereas there is something to get back in the case of the mortgage.[49]

The above comments apply equally to the equitable mortgage although, in practice, it may be difficult to determine whether a particular transaction is an equitable mortgage or charge.[50] However, it is hard to imagine circumstances in this country where it might be important to distinguish the two.

The Assimilation of Mortgage and Charge

Although there are these fundamental differences between the mortgage and charge, there will not be too many situations nowadays involving chattel securities where it is important to make the distinction. In practice, it will usually be a question of distinguishing mortgages and charges from other secured transactions. This is because in all the relevant provisions of the Chattels Transfer and Companies Acts looked at earlier mortgages and charges are lumped together. Thus, both mortgages and charges granted by companies are excluded from the Chattels Transfer Act and the term "charge" in s.102 of the Companies Act in-

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45. E.g. in *Re Slee* (1872) L.R. 15 Eq. 69, 73 where Bacon C.J. regards the charge as transferring "the property" to the chargee.
46. *Stainbank* v. *Fenning* (1851) 11 C.B. 51, 88, 138 E.R. 389, 403; *Burlinson* v. *Hall* (1884) 12 Q.B.D. 347, 350; *Tancred* v. *Delagoa Bay and East Africa Rly. Co.* (1889) 23 Q.B.D. 239, 242; *London County and Westminster Bank* v. *Tompkins* [1918] 1 K.B. 515, 528.
47. Note 11, at pp. 15-16.
48. Ibid., at p. 15.
48a. Salmond, *Jurisprudence* (12th ed. 1966) 430.
49. Note 11, at p. 16. See also *Kennard v. Futvoye* (1860) 2 Giff. 81, 92-93, 66 E.R. 35, 40. Of course, the chargor does have an equity of redemption in the sense that he can remove the chargee's proprietary rights and restore full unencumbered ownership by satisfying the chargee's claim.
50. See generally Sykes, note 11, at pp. 128-131, 158-159, 451-452, 824.

cludes "mortgage." In addition, the remedies of the chargee and mortgagee have largely been assimilated. Not only can the instrument of charge confer wide powers on the chargee, but also the covenants and powers in the fourth schedule of the Chattels Transfer Act will be implied in both mortgages and charges, although some of the covenants are inappropriate for charges in that they talk about "the chattels hereby assigned". Accordingly, if a person executes an instrument "charging" his car as security for a debt, he will in most respects be in the same position as a mortgagee for he is entitled to take possession and sell on default.[51]

However, it would be wrong to suggest that the distinction is now devoid of all practical significance and that the holder of an equitable charge can be regarded as akin to a mortgagee for all purposes. In the context of certain priority conflicts, the distinction will still be vital. Take the following example. X Ltd. gives an ordinary legal chattel mortgage over its car to A. which is not registered under the Companies Act. X Ltd. later fraudulently sells the car to B, a bona fide purchaser for value without notice. A. can reclaim the car because there are no applicable exceptions to the *nemo dat* rule and s.103 of the Companies Act does not avoid unregistered mortgages/charges against purchasers. However, if A's security was a charge, B. would prevail because X Ltd. has retained legal title and B. has no notice of A's equitable interest. Similarly, if B. was not a purchaser but a mortgagee of X Ltd's legal title, although here he would have the added protection of s. 103.

The Charge and Instruments By Way of Bailment

All that has been said earlier[52] with respect to the *mortgage*/instrument by way of bailment distinction obviously applies *a fortiori* with respect to the charge and the instruments by way of bailment. The grantee of a conditional sale, hire purchase or lease agreement is clearly not mortgaging his assets let alone charging them. Nor for that matter, is the *grantor*. He is a seller or hirer and is obviously not charging his assets as security for a debt.

The Charge/Possessory Security Distinction

The distinction between the charge and the possessory securities is also clear cut. The pledge and the contractual possessory lien both involve the bailment of a chattel as security for a debt. The debtor transfers to his creditor one out of his bundle of ownership rights, the right to possession. The creditor's security is his *actual possession* and, in the case of the pledge, his right to sell the chattel on default. On repayment it remains for possession to be restored to the debtor. In the case of a charge, however, as seen earlier, there is no such splitting of ownership rights. The chargee has no actual "enjoyment" rights but mere potenti-

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51. See cl. 7 of the implied covenants.
52. Ante p. 287.

ally exercisable rights which automatically cease on repayment, there being nothing to restore to the debtor.

The distinction was recognised and implemented in the early New Zealand case of *The Mayor of Karori* v. *A.M.P. Society*[53] but not fully, as we shall see shortly, in the *Waitomo Wools* case.

Mortgages/Charges and Absolute Assignments/Sales

The only other transaction which remains to be distinguished from the charge (and the mortgage) is the absolute assignment or sale of property. As noted earlier,[54] the absolute assignment of book debts is essentially a secured financing transaction. However, because it is a sale, the courts have consistently distinguished it from the assignment by way of mortgage and the charge on book debts, often with important legal consequences.[55] As explained by Romer L.J. in *Re George Inglefield Ltd.*,[56] a sale differs from a charge (and mortgage) in three fundamental respects. The most important difference is that on a sale the vendor is not entitled to get back what he has sold by returning the purchase price. Whereas, in the case of a charge, the chargor is entitled to get back full unencumbered ownership by discharging the debt or obligation secured. He has what may loosely be described as an equity of redemption. The other distinctions flow from this fact that the sale is a "once and for all" disposition whilst the charge is only security for an obligation. First, if the chargee realises the subject matter of the charge for an amount *more* than is sufficient to repay him the debt plus costs, he must account to the chargor for the surplus. In the case of a sale, the purchaser does not, of course, have to account to the vendor for the profit he makes on a subsequent sale. Secondly, if the chargee realises the property for an amount *less* than is due to him, he usually has a personal action in contract for the balance. If a purchaser makes a loss on a subsequent sale he obviously has no recourse to the vendor.

IV. RECENT CONSIDERATIONS OF THE CHARGE

As mentioned in the introduction, the meaning of "charge" has been considered twice by the Court of Appeal in recent years — in *Paintin and Nottingham Ltd.* v. *Miller Gale and Winter*[57] and *Waitomo Wools (N.Z.) Ltd.* v. *Nelsons (N.Z.) Ltd.*[58] In both cases, but particularly the latter, the court created some unnecessary problems for itself by not fully recognising the fundamental property concepts outlined above.

53. (1911) 30 N.Z.L.R. 438.
54. Note 9.
55. See *Re George Inglefield Ltd.* [1933] Ch. 1; *Ashby, Warner & Co. Ltd.* v. *Simmons* [1936] 2 All E.R. 697; *Palette Shoes Pty. Ltd.* v. *Krohn* (1937) 58 C.L.R. 1, 25; *Re Kent & Sussex Sawmills Ltd.* [1947] Ch. 177; and *Re An Application By Tileman N.Z. Ltd.* (1973) 14 M.C.D. 70.
56. [1933] 1 Ch. 1, 27-28. See also *Stonleigh Finance Ltd.* v. *Phillips* [1965] 2 Q.B. 537, 568, 574.
57. [1971] N.Z.L.R. 164.
58. [1974] 1 N.Z.L.R. 484.

Paintin's Case

The essential facts for present purposes were as follows. Owers Bros. Ltd. (Owers) were the owners of a dredge which was built for them by the appellants (Paintins). A substantial amount was still owing in respect of the dredge and Paintins wanted a security. This was achieved by Owners selling the dredge to Paintins and Paintins agreeing to resell it to Owers pursuant to a conditional sale agreement. Under this agreement, which was registered under the Chattels Transfer Act but not the Companies Act, Owers were credited with the amount already paid to Paintins, the balance being payable by instalments. Later the respondents (execution creditors of Owers) seized the dredge. Their entitlement to it depended upon whether the conditional sale agreement was a security which should have been registered pursuant to s. 102 of the Companies Act.

Having determined that the conditional sale agreement was not a sham (in reality a chattel mortgage granted by Owers), the question then arose whether it was a charge caught by s. 102. Turner J., who delivered the leading judgment on this point, had:

> "no doubt that the conditional purchase agreement, under which a company *buys* as conditional purchaser, is not a charge . . ."

He thought that:

> "the word "charge" must signify the giving of a security by way of mortgage, lien, or encumbrance or to like effect over property the ownership of which is and remains in the grantor"[58a]

which was not the case here.

Clearly, this decision is right. A company buying a chattel pursuant to a conditional sale agreement is not charging its property. It is not creating rights over its own asset. Title is in the vendor. It is the latter who grants the instrument, not the company.

There are, however, two aspects of Turner J's judgment which require comment. First, his definition of "charge" quoted above. The suggestion that "the giving of a security by way of . . . lien" is a charge is clearly wrong. It was corrected in the *Waitomo Wools* case and further comment will be left until that case is considered. The major problem with the definition lies in the last words "or to like effect over property the *ownership of which is and remains in the grantor.*" This description is capable of catching the pledge, where ownership is in and remains in the pledgor. Yet, as seen earlier, the pledge is clearly not a charge. In addition, the mortgage, which is included in the first part of the definition no doubt because "charge" includes "mortgage" for the purposes of s. 102, is not normally described as a security whereby *ownership remains* in the grantor.

58a. [1971] N.Z.L.R. 164, 179.

"Ownership" is, of course, an ambiguous word. It is most commonly used as synonymous with title or the right to dispose of the property. Turner J. cannot have meant *title* because, in the case of a mortgage, title is transferred to the mortgagee. It is the essence of his security. What then did His Honour mean? As noted earlier,[59] the true position is that when a person has ownership of property he has a bundle of rights, such as the rights of possession and of enjoyment and the right of disposal. He may transfer some of these rights but retain others. In the case of a mortgage, the mortgagor parts with his right of disposal, but retains rights to possession and to restore full ownership. Since ownership rights are divided between the two parties, it cannot truly be said that the mortgagor *remains* the owner or that the mortgagee *is* the owner.

As a result, Turner J's definition can be sustained only if the word "ownership" is used in the sense of a retention by the grantor of some residue of proprietary rights and, in the case of the mortgage, this is the right of redemption, the right to get his title back and to assume his full ownership rights.

In view of the above difficulties, it is suggested that the following would be a more accurate definition:

> A charge, except to the extent that the mortgage is expressly included by statute, is a security whereby, without any transfer of or agreement to transfer title/ownership or possession, property is appropriated to the discharge of a debt or other obligation.

The other aspect of Turner J's judgment which requires comment is his emphasis of the word "buys", when he said that an agreement under which a company buys as conditional purchaser is not a charge. This is open to the *possible* interpretation that he is limiting his decision to conditional *purchases* by companies and is leaving open the situation where the company is the conditional *vendor*. However, there is clearly no charge in the latter situation. There is no debt owing by the vendor nor does he have a right of redemption. He cannot say to the purchaser "here, have your money back, I want my property". The transaction is a sale, not a charge.[60]

The Waitomo Wools Case

The essential facts for present purposes were that a company granted a contractual possessory lien which, when the company went into receivership, was claimed, inter alia, to be void as an unregistered charge under s. 103 of the Companies Act. The claim was rejected by the Court of Appeal. This decision too was clearly right. It is

59. Note 17, quoting Sykes, note 11, at p. 6.
60. If it were a charge, the absurd result would follow that a conditional purchaser from a company would have to register his agreement with the Registrar of Companies in order to avert the possibility of the company's creditors seizing the property the subject of the agreement.

incontestable, for the reasons mentioned earlier, that a possessory lien is an entirely different form of security transaction from a charge. Unfortunately, the Court of Appeal did not see the issue as one quite so easily resolved.

Richmond J., who delivered the court's judgment, regarded the word "charge" as[61]

> "apt only to describe a situation in which some particular property, real or personal, is appropriated or set aside in favour of someone who is given by law, or by agreement, will or otherwise, the right to resort to the property to satisfy or discharge some obligation . . . A charge involves some deduction from the right of ownership in the property rather than a mere interference with the right to possession . . ."

For this reason, the purely possessory lien did not create a charge. It "depends entirely on possession and is lost with the loss of possession" whereas a charge "exists independently of possession and confers an interest in the property which carries with it a *right* to resort to the property, (as opposed to merely detaining it) to satisfy or discharge some obligation secured by the charge."[62] An *equitable lien*, on the other hand, *was* regarded as in the nature of a charge. It does not depend on possession and differs from the equitable charge only in that it arises by operation of equity rather than by act of the parties.

The latter distinction between possessory and equitable liens was used by Richmond J. to explain the reference to "lien" in Turner J's definition of "charge" in *Paintin*. In His Honour's view, it was "clearly used only as referring to such liens as take effect by way of charge".[63]

Later in his judgment, Richmond J. restated what he saw to be the essential difference between a possessory lien and a charge as follows:[64]

> "the former is a purely personal right dependent on continued possession and the latter an interest in property which is not dependent on possession."

If Richmond J's judgment had centred around the above comments only, then there could have been no objections of any great moment. One might merely have commented that, if Turner J. in *Paintin* intended to include only the *equitable* lien in his definition of charge, the reference was rather pointless because the registration provisions of the Companies Act are clearly inapplicable to such a security. They catch only charges created by act of the parties.[65] In addition, it might have been observed that it was not strictly accurate to describe a charge as involving "some deduction

61. [1974] 1 N.Z.L.R. 484, 490.
62. Ibid.
63. Ibid., at p. 493.
64. Ibid.
65. See note 8.

from the right of ownership" and a possessory lien as "a purely personal right". As explained earlier, the chargor parts with none of his ownership rights. Clearly also, the holder of a possessory lien has a property interest. If, for example, possession is lost through an unlawful seizure by the lienee or his creditors or it is redelivered for a limited or specified purpose,[66] the lienor retains his prior claim.

By themselves, these comments are rather carping because the essential holding that a possessory lien is not a charge is unchallengeable. However, they do assume greater importance and are indicative of a more fundamental misconception when one comes to another part of the judgment which suggests that the other possessory security, the pledge, *is* a charge.

Counsel for the appellant cited the opinion of Lord Parker in *Dublin City Distillery Ltd* v. *Doherty*[67] in support of his argument that the lien constituted a charge. Lord Parker stated that for the purposes of the then English equivalent of s. 102, the expression "mortgage or charge" *did* include the common law pledge. Richmond J. did not disagree and merely pointed out that it was not authority for holding that a possessory lien is a mortgage or charge because it is conceptually distinct from a pledge. In his view[68]

> "a legal lien is an unassignable personal right which subsists only so long as possession of the goods persists whereas a pawn or pledge give a special assignable interest in the property to the pawnee."

The clear inference from his reply to counsel's argument is that a pledge *is* a charge. Such a proposition cannot be sustained. It is entirely out of step with the authorities and fundamental property law concepts outlined earlier. Although the pledge, mortgage and charge all confer assignable proprietary rights enabling the creditor to resort to the property on default, that is all they have in common. The right to resort is a characteristic of the charge but it is not the one which determines whether a particular security is a charge. The distinction outlined above between the possessory lien and the pledge is important but it cannot have the effect of converting the latter into a charge.

It is to be noted also that Lord Parker's statement did not represent a majority opinion of the House of Lords and, even in the context of his own judgment, can be regarded as *obiter*. All of their Lordships, including Lord Parker, in fact held that the transaction in question did not effect a common law pledge, but amounted, at the most, to an equitable charge. Only Lord Parker and Lord

66. *Albermarle Supply Co. Ltd.* v. *Hind & Co.* [1928] 1 K.B. 307.
67. [1914] A.C. 823, 854.
68. [1974] 1 N.Z.L.R. 484, 492.

Halsbury (concurring) suggested that, if the transaction was a pledge, it was still a charge and void for non-registration.[69]

Richmond J.'s apparent acceptance of the proposition that a pledge is a charge is also inconsistent with his earlier description of the characteristics of a charge. He stated that a charge "exists independently of possession."[70] A pledge, of course, does not. As is the case with the possessory lien, the creditor's rights are lost once possession is redelivered to the debtor unless it is for a limited or specific purpose. The only difference between the possessory lien and the pledge, apart from the right to sell on default, is that the pledgee has an interest which he may assign to third parties.

Furthermore, if the pledge is a charge, new avenues of argument are thrown up with respect to the contractual possessory lien. Richmond J., in the course of his judgment,[71] suggested that the latter would not be a charge even if it conferred an express power of sale. For this proposition he relied on the House of Lords' decision in *Great Eastern Rly Co.* v. *Lord's Trustee*[72] which, while clearly deciding the point, is not entirely satisfactory because the English Bills of Sale Act 1878 under which the case was decided, unlike the New Zealand Chattels Transfer Act, applies only to securities over chattels the possession of which remains in the grantor/debtor. Since the grantee had possession and the security lasted only so long as possession was retained, there was simply no question of the lien being a bill of sale, let alone a *charge*. Anyway, this point aside, if a pledge is a charge, is there any valid reason for not according the possessory lien coupled with a power of sale the same status? The only difference between the two is that the latter is not assignable, a characteristic which, by itself, is not sufficient for denying it the status of a charge. In addition, as noted earlier,[73] there have been suggestions that a lien by contract should be regarded as in the nature of a pledge. They can be invoked *a fortiori* in the case of a lien which actually confers a power of sale.

V. CONCLUSION

It is apparent from the Chattels Transfer Act 1924 and the registration provisions of the Companies Act 1955 that the term charge is used in its technical sense and that whether a particular

69. Lord Parker cited *Re South Durham Iron Co.* (1879) 11 Ch.D. 579 as authority for this proposition. However, there is no suggestion whatsoever in the report of that case that the security in question was a pledge. What it was is unclear, but it seems to have been regarded as either a mortgage or an equitable charge. There is nothing in the case to suggest that these terms were being used in other than their technical senses. Furthermore, all the cases discussed concerned mortgages and equitable charges.
70. See note 62.
71. [1974] 1 N.Z.L.R. 484, 491.
72. [1909] A.C. 109.
73. Ante p. 288.

secured transaction can be classified as a charge may have important practical consequences. It is a security possessing its own peculiar characteristics and must be kept distinct from all the other forms of secured transaction. A mortgage is not a charge, although the necessity to distinguish them will not arise too often nowadays. More importantly, there is no charge where the transaction is an absolute assignment/sale, a mere licence to seize, one of the instruments by way of bailment, a possessory lien or a pledge. The suggestions to the contrary with respect to the latter in the *Dublin City Distillery* and *Waitomo Wools* cases are entirely contrary to established principle and ought not to be followed.

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