Marshalling

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This paper examines the operation of the equitable doctrine of marshalling in New Zealand. The author intends it to be a definitive account, and thus discusses a range of issues - its juridical nature, how to exercise a marshalling claim, limitations, the position of third parties, and covenants against marshalling.

I INTRODUCTION

> Marshalling is [an equitable] doctrine which enables a [creditor] who has no security in law or equity against [an] asset ... to become subrogated to such a claim.[1]

Marshalling is an established part of New Zealand law[2] and the purpose of this paper is to provide the first definitive account of it in New Zealand.

As marshalling claims are relatively uncommon all aspects of the doctrine are canvassed, but for the most part this paper deals with marshalling as between secured creditors as opposed to marshalling between beneficiaries and/or creditors under an estate, the other area where marshalling can apply.

Five of the major issues discussed are, the juridical nature of marshalling, the exercise of a marshalling claim, the limitations of marshalling, marshalling in relation to third parties and covenants preventing marshalling. Since its creation, the juridical nature of marshalling (the basis upon which a marshalling claim is exercised) has remained a moot point. This has caused much uncertainty in relation to the exercise of marshalling claims. Hence this is also discussed. There is more certainty as to the limitations of marshalling, but for conciseness these are also set out in full. Marshalling in relation to third parties (unsecured creditors and volunteers) is the most contentious issue yet to be settled and is discussed at length. The final issue to be

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1 *Bisset* v *Australia and New Zealand Bank Ltd* [1961] NZLR 687, 694.

2 *Brigham* v *Saunders* (1880) OB & F 66; *Ollivier and Others* v *Colonial Bank* (1887) 5 NZLR 239; *The King* v *The Westport Harbour Board* (1905) 25 NZLR 449; *In re Islip, Ex parte Official Assignee* (1907) 26 NZLR 1923; *Re Stephenson* (1910) 30 NZLR 145; *New Zealand Loan and Mercantile Agency Co* v *Loach* (1911) 31 NZLR 292; *In re Taylor, Ex parte Dalgety & Co* [1934] NZLR 117; *In re Tremain, Tremain* v *Public Trustee* [1934] NZLR 369; *In re Ainge, Wheeler* v *Bank of Australia* [1935] NZLR 691; *In re Watkins, Guardian Trust and Executors Co* v *Watkins* [1938] NZLR 847; *In re Coote, Coote* v *Public Trustee* [1939] NZLR 457; *Bisset* v *Australia and New Zealand Bank Ltd* [1961] NZLR 687; *Re Manawatu Transport Ltd* (1984) 2 NZCLC 99, 084.

discussed is covenants preventing marshalling. At present, marshalling's far-reaching application is not well utilised. However, if and when marshalling becomes more prominent the area of "covenants preventing marshalling" is likely to lead to the most interesting legal developments.

II WHAT IS MARSHALLING?

Marshalling was created by the Chancery courts of the mid-eighteenth Century as a response to the claims of creditors that the recovery of debts from bankrupts was being frustrated by the prejudicial acts of prior creditors. For example:

CHARGOR	
Property X	*Property Y*
Chargee A	Chargee A
Chargee B	

In this example, the chargor charges properties *X* and *Y* in favour of A, the multiple chargee, as security for a debt. The chargor then charges property *X* in favour of B, the single chargee, as security for another debt. Here A can frustrate B's chances of recovering its debt by satisfying its own debt from *X*, the doubly charged property, rather than seeking recourse from *Y*, the singly charged property. To avoid this outcome, marshalling provides that, if A acts in such a prejudicial manner, B is entitled to "marshal" against A for any "surplus security" still held over property *Y*.[3] In other words, marshalling gives B access to property in which it had no prior interest.

III SOME WORKING DEFINITIONS

It is important to define at the outset some of the terms used in this paper.

A "multiple chargee" is a secured creditor who holds "surplus security" to which a "single chargee" wishes to gain access.

"Surplus security" is a fund consisting of the unused or leftover property of the multiple chargee's security agreement. It is "unused or leftover" in the sense that it is not required to satisfy the multiple chargee's debt.

Unless the context otherwise requires, "property" denotes *both* real and personal property.

Finally, a "charge" denotes any situation in which "property" is encumbered whether it be by charge, lien, mortgage or pledge.

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3 *Lanoy* v *Duchess of Athol* [1742] 2 Atk 444, 26 ER 668.

IV THE JURIDICAL NATURE OF MARSHALLING

A fundamental problem in marshalling is that, even though the doctrine was created almost two hundred and fifty years ago, the juridical nature of marshalling (the basis upon which the doctrine is applied) is yet to be settled.

There are two different schools of thought on this. The first suggests that the right of the single chargee to have the doctrine applied in its favour is "proprietary". The second suggests that the right to marshal is less than proprietary and is akin to that of a right of subrogation, ie to be subrogated to the position of the multiple chargee in respect of the surplus security.

A Proprietary Interest

The proprietary interest school believes that the single chargee has an equitable interest in the surplus security held by the multiple chargee. This is evidenced by the English case of *Lawrence* v *Galsworthy*.[4] There the mortgagor granted a first mortgage over two lots of property to the multiple chargee, A, and later granted a second mortgage over one lot of property to the single chargee, B. A, under a mortgagee sale, sold both lots of property subject to the security agreement to recoup its debt. It then returned the funds including the surplus security to the mortgagor. This discharged the mortgage over which B claimed marshalling rights. The court held that although the purchaser of the property was a purchaser for value, it had notice of B's claim and was compelled to recognise it. The sale was set aside and B was granted access to the property to satisfy its debt.

On the assumption, for the moment, that the "proprietary interest" analysis is the correct analysis, questions then arise how and when this interest is created.

In theory the interest, and therefore the right to marshal, cannot arise before the multiple chargee has satisfied its debt. If it did, and the property involved was real property, the single chargee might have a caveatable interest[5] in the singly charged security and could inhibit the multiple chargee's freedom of realisation of the property. It is a common misconception that marshalling enables a single chargee to *direct* the multiple chargee to realise its security in such a way to cause the least prejudice to common property (property charged both by the multiple chargee and the single chargee). One of the fundamental principles of marshalling is that the operation of the doctrine does *not* restrain the multiple chargee from realising the security of its choice.[6]

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4 (1857) 3 Jur (NS) 1049, (1857) 30 The Law Times 112.

5 If the interest is an interest in land it is caveatable under sections 136 and 137 of the Land Transfer Act. This, in effect, prevents any disposition of the real property.

6 *Union Bank of Georgetown* v *Laird* (1817) 15 US 390, 392; *Wallis* v *Woodyear* (1885) 2 Jur (NS) 179; *Ernst Bros Co* v *Canada Permanent Mortgage Corp* (1921) 57 DLR 500, 505; *Commonwealth Trading Bank* v *Colonial Mutual Life Assurance Society Ltd* [1970] Tas SR 120, 128; *In re O'Leary, Ex parte Bayne* (1985) 61 ALR 674, 680; *Mir Bros Projects Pty* v *Lyons* [1977] 2 NSWLR 192, 196; *Deta Nominees Pty Ltd* v *Viscount*

To hold otherwise would be to diminish the multiple chargee's *prior and paramount* claim in favour of a subsequent encumbrancer with a weaker security. Equity stops short of imposing upon the multiple chargee any obligation to keep the security agreement alive for the benefit of the single chargee.[7]

Therefore, any equitable interest in the surplus security and any right to marshal is extinguished upon the *bona fide* transfer of the charged property to a third person or upon the discharge of the multiple chargee's security agreement.

There are, however, three reasons why the proprietary school does not correctly analyse the doctrine.

First, it follows that if the single chargee has an equitable interest in the surplus security, then the multiple chargee can simply assign the legal interest over to the single chargee. However, it has been said that "the operation of the marshalling principle depends upon the assets being subject in some way to the control of the court ...".[8] In the leading New Zealand authority on marshalling, *Re Manawatu Transport*, Eichelbaum J cites with approval a similar statement: "if the matter is under the Court's control ...".[9] The apparent necessity of judicial consent to transfer surplus security indicates an interest somewhat less than proprietary. Secondly, there is no recent judicial support for the proprietary interest school apart from some American cases,[10] which should be read in the context of the American view of marshalling. Thirdly, there is much judicial support for the idea that marshalling is not a proprietary right, but an "equitable remedy" sought in lieu of the possibility that the single chargee's security might be prejudiced by the multiple chargee's realisation of common

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Plastic Products Pty Ltd [1979] VLR 167, 192; *Re Manawatu Transport Ltd* (1984) 2 NZCLC 99,084, 99,087; *First Investors Corporation* v *Veeradon Developments Ltd* (1988) 47 DLR (4th) 446, 451. See *Webb* v *Smith* (1885) 30 ChD 192, 200; *Bank of NSW* v *City Mutual Life Assurance Society Ltd* [1969] VR 556, 557 for the contrary argument. There is also an exception to the rule that the doctrine does not restrain the mutliple chargee from realising the security of its choice. Where an agent pledges the goods of its principal and goods of its own as security for a debt it owes, the case law suggests that the principal may compel the creditors to seek recourse from the agent's goods first: *Broadbent* v *Barlow* (1861) 3 De GF & J 870; *Ex parte Alston* (1868) LR 4 Ch App 168; *Ex parte Salting* (1883) 25 ChD 148; *Re Burge Woodall & Co* [1912] 1 KB 393.

7 *Commonwealth Trading Bank* v *Colonial Mutual Life Assurance Society Ltd* [1970] Tas SR 120, 132.

8 *Commonwealth Trading Bank* [1970] Tas SR 120, 128; *Webb* v *Smith* (1885) 30 ChD 192, 200.

9 (1984) 2 NZCLC 99,084, 99,087. Quote from *Halsbury's Laws of England* (4 ed, Butterworths, 1980) Vol 16, para 1426.

10 *Meyer* v *United States* (1963) 375 US 233; *Markman* v *Russel State Bank* (1966) 358 F 2d 488; *US* v *Le May* (1972) 346 F Supp 328; *In re Penn Cent Transport Co* (1972) 346 F Supp 1323; *Seasons Inc* v *Atwell* (1974) 527 P 2d 792; *Bartley* v *Pikeville National Bank & Trust Co* (1976) 532 SW 2d 446.

securities.[11] Marshalling "is no more than [a right] to seek a remedy which the court will in certain circumstances grant".[12]

B Subrogation

Under the subrogation analysis the single chargee has a right to apply to the courts to be subrogated to the rights of the multiple chargee in respect of the surplus security. This right of subrogation arises once the multiple chargee depletes common property to the point where the single chargee is unable to satisfy its debt fully. The single chargee must then apply to the courts to marshal against the multiple chargee, that is, to be subrogated to the multiple chargee's rights in respect of the surplus security. However, this right is extinguished upon either the *bona fide* transfer of the surplus security to a third party or the discharge of the security agreement, for in these cases the single chargee has nothing to be subrogated to.

Under the subrogation analysis, marshalling does not create an "equitable interest" in the surplus security, only an "equity" (or a "mere equity"). There is no judicial support for this proposition, but the characteristics of the subrogation analysis (that there is a "personal" claim against the multiple chargee and that any claim is defeated by a "*bona fide* transfer" of the surplus security) are consistent with the concept of an "equity".[13]

Treated as an "equity" marshalling remedies the situation where the multiple chargee disposes of the charged property in bad faith and there is knowledge of this bad faith on the part of the third party transferee. A person who takes with notice of an equity is sometimes subject to that equity.[14]

Alternatively, it can be argued that, once the multiple chargee has notice of the single chargee's claim, a fiduciary relationship arises. The nature of this fiduciary relationship is that the multiple chargee must act in good faith towards the single chargee's claim and upon a transfer in bad faith of the surplus security to a third party, who takes with knowledge of this bad faith, a constructive trust attaches to the surplus security and it becomes traceable.[15] There is no judicial support for this proposition, but if the necessary facts arise it is unlikely that the courts will be unwilling to attach some liability to the multiple chargee and any third party transferee where there is an absence of good faith.[16]

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11 *Ernst Bros Co* (1921) 57 DLR 500, 505; *Commonwealth Trading Bank* [1970] Tas SR 120, 128; *Re O'Leary* (1985) 61 ALR 674, 680; *Mir Bros Projects Pty* v *Lyons* [1977] 2 NSWLR 192, 196; *Deta Nominees Pty Ltd* [1979] VLR 167, 192; *Re Manawatu Transport Ltd* (1984) 2 NZCLC 99,084, 99,087.

12 Above, n7, 130.

13 *Hanbury & Maudsley: Modern Equity* (Jill Martin) (13 ed, Stevens & Son Ltd, London, 1989) 871.

14 Above n13.

15 *Phipps* v *Boardman* [1967] 2 AC 46.

16 "Third party transferee", here, also includes the chargor.

Marshalling as a remedy akin to subrogation is the prevalent view in the case law in New Zealand[17] and has support in Australia,[18] Canada[19] and England.[20] This interpretation also avoids the objections to the proprietary interest analysis.[21]

From a New Zealand perspective the best summary of the doctrine is that quoted earlier in the introduction:[22]

> Marshalling is a doctrine which enables a person who has no security in law or equity against [an] asset ... to become subrogated to such a claim, if the creditor entitled to resort to this and other assets by his election deprives him of security.

The doctrine has broad application. It applies to all consensual security interests and pledges.[23]

V THE AMERICAN POSITION[24]

It is interesting to compare the conclusion reached above (that marshalling is a remedy akin to subrogation) with the view taken by the American courts. In the latter marshalling is seen as a double edged sword, not only as a remedy (by subrogation), but also as a "right": the single chargee *can* compel the multiple chargee to exhaust the singly charged property before seeking recourse to the common property.[25] However, as discussed earlier, by allowing the single chargee to direct the multiple chargee to realise the securities in a manner that causes the least prejudice to the single chargee, the multiple chargee's prior and paramount claim is subjected to the claim of a subsequent and weaker encumbrancer.[26] This affords the single chargee too much power. The purpose of having a "prior" claim to "multiple" securities is both to ensure repayment if each property, by itself, is insufficient *and* to have priority over those properties in satisfying its debt. This entitlement of the multiple chargee should not then be subjected to the subsequent claim of the single chargee. In the author's opinion, marshalling as a remedy akin to subrogation is the most "equitable" analysis of the

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17 Above n2.

18 *Commonwealth Trading Bank* [1970] Tas SR 120, 128; *Mir Bros Projects Pty* [1977] 2 NSWLR 192, 196; *Re O'Leary* (1985) 61 ALR 674, 680.

19 *Ernst Bros* (1921) 57 DLR 500, 505; *First Investment Corporation* (1988) 47 DLR (4th) 446, 451, 452, 453.

20 *Aldridge* v *Forbes* (1839) 4 Jur 20; *Re Mower's Trusts* (1869) LR 8 Eq 111.

21 Subrogation is a remedy for which a single chargee must apply to the courts (objection 1), and it has judicial support (objection 3).

22 Above n1.

23 *Fisher & Lightwood's Law of Mortgage* (WR Fisher, ELG Tyler, and JM Lightwood) (9ed, Butterworths, London, 1977) para 446 . As to liens see *Trimmer* v *Bayne* (1803) 9 Ves 209 and *Sproule* v *Prior* (1826) 8 Sum 187. As to pledges, see above n6.

24 For the purpose of this paper the jurisdictions of the United States of America will be treated as one.

25 Above n11. See also FW Koger and P Acconcia "Marshalling: A Fourth Act Sequel To Commercial Tragedies?" (1989) 57 UMKCLR 205, 207.

26 See Part IV above.

doctrine. The multiple chargee's rights remain paramount and at the same time the single chargee is granted access to alternative property to satisfy its debt.

VI THE APPLICATION OF THE DOCTRINE

A Who is Entitled to Marshal?

It is accepted that marshalling applies in favour of a single chargee, but who then is a single chargee? A single chargee is:

1 Any person claiming property subject to the multiple chargee's security agreement; and

2 who has a subsequent or reversionary interest in multiply charged property; and

3 whose interest is jeopardised or prejudiced by the realisation of common property by a multiple chargee.

The definition of single chargee does not include the debtor or chargor itself, nor its trustee in bankruptcy, its personal representative(s)[27] or other persons who do not, for value, take by assignment, charge or conveyance an actual interest in one of the securities.[28] However, a "single" chargee *may* have more than one security. For example:

	CHARGOR	
Property X	*Property Y*	*Property Z*
	Chargee A	Chargee A
Chargee B	Chargee B	
	Chargee C	

In this situation B is potentially a single chargee in relation to A, because A is a person who has a prior interest in common property, *Y*, who could prejudice B's charge over *Y* by realising *Y* before *Z* to satisfy its debt. Conversely, A is a multiple chargee because A has access to property in satisfaction of its debt that B has no interest in. However, in respect of C both A and B are multiple chargees because of their access to *X* and *Y*.

B Whom does the Doctrine Affect?

A single chargee is able to marshal only by virtue of surplus security held by the multiple chargee over an *undischarged* security agreement. For this reason, a multiple chargee is a *necessary* party to any marshalling proceedings. The operation of the doctrine will, however, affect various other parties: the debtor or chargor itself, its

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27 *Re Fox* (1856) 1 ChD 541; *Ansley* v *Newman* (1870) 39 LJ Ch 769. See also *Halsbury's* vol 32 para 916 and *Fisher & Lightwood* 448.

28 See Part IX below for the position of unsecured creditors and volunteers.

trustee or equivalent in bankruptcy, its personal representative(s) and, possibly, other single chargees.

The multiple chargee is *not* affected by marshalling claims, because, as explained earlier, marshalling in New Zealand does not operate to restrain the realisation of the securities held by the multiple chargee.[29] The multiple chargee has a prior and paramount claim to the property.

C *Exercising a Claim to Marshal*

A marshalling claim by a single chargee is generally established by giving notice of it to the multiple chargee. A marshalling claim cannot be given too early, but it can be given too late. For example, a claim is ineffective if made after the disposition of the surplus security to a third party or if the multiple chargee's security agreement is discharged. In these cases the single chargee has nothing to be subrogated to. The only option for the single chargee is to prove bad faith on the part of the multiple chargee,[30] in which case the single chargee may be able to trace the surplus security into the hands of third parties, if they also took in bad faith.[31]

In order to exercise a claim to marshal, a single chargee must commence proceedings[32] after the creation of the "surplus security" and before the surplus security is extinguished. If, however, proceedings cannot be commenced in time, an injunction *quia timet* might be possible, restraining the multiple chargee from transferring the surplus security or discharging the security agreement.[33]

Therefore, it is important for the single chargee both to give notice of a marshalling claim[34] and to be prepared to commence proceedings before or upon the creation of the surplus security. No marshalling claim is guaranteed. It is not an enforceable interest, it is only a right "to seek a remedy which the court will in certain circumstances grant".[35]

Also, it is generally said that marshalling only applies where the property, subject to the marshalling claim, is in court or where the court can exercise a jurisdiction over

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29 See Part IV above.

30 Bad faith here could be defined as any attempt to knowingly defeat a single chargee's marshalling claim, but ultimately it will be up to the Courts to decide.

31 See Part IV above.

32 Proceedings generally take the form of an originating summons.

33 *Quia timet* prevents that which is feared as a future injury. To succeed two requirements must be satisfied. First, if there is no actual damage then future damage must be highly likely, if not imminent. Secondly, the likely damage must be substantial. *Fletcher* v *Bealey* (1885) 28 Ch 658; *Morris* v *Redland Bricks Ltd* [1970] AC 652.

34 As of yet there is no evidence of any doctrine of "constructive notice" of marshalling claims.

35 Above n7, 130.

it, such as in the administration of estates or in liquidations or bankruptcies.[36] However, "there is no reason why this is an essential element for the application of marhsalling".[37]

VII LIMITATIONS ON THE RIGHT TO MARSHAL.

Marshalling generally benefits the single chargee who is granted access to surplus security before it reverts back to the chargor. However, there are a number of limitations on the doctrine. These limitations attempt to balance the competing interests of all the parties involved. Some have already been outlined[38] and, in this section of this paper, the remaining ones will be examined.

1 No right to marshal exists where the multiple chargee *does not have equal right of recourse to each property to satisfy its debt*: for example, where the multiple chargee is bound to resort to one property before resorting to another.[39]

This limitation is a useful means for a chargor to prevent marshalling claims and will be developed further in Part X below, "Covenants Preventing Marshalling".

2 Marshalling will not operate to the prejudice of third parties.[40]

3 Both the properties must be in existence when the marshalling claim arises.[41]

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36 *Lawrence* v *Galsworthy* (1857) 3 Jur (NS) 1049; *Webb* v *Smith* (1885) 30 Ch D 192, 200; *Jenkins* v *Brare & Gair* (1902) 27 VLR 643, 648; *Commonwealth Trading Bank* v *Colonial Mutual Life Assurance Society Ltd* [1970] Tas SR 120, 127; *Re Manawatu Transport Ltd* (1984) 2 NZCLC 99,084, 99,087.

37 *Equity: Doctrines and Remedies* (RP Meagher, WMC Gummow and JRF Lehane) (2 ed, Butterworths, Sydney, 1984) para 1117. *Webb* v *Smith* (1885) 30 Ch D 192 is a case where the property subject to the marshalling claim was not under the control of the court.

38 The creation and extinguishment of a marshalling claim. See Part VI C.

39 *In re The "Priscilla"* (1859) Lush 1, 167 ER 1; *Douglas* v *Cooksey* (1868) 2 IR Eq 311, 315; *Dolphin* v *Aylward* (1870) LR 4 HL 486, 505; *Webb* v *Smith* (1885) 30 ChD 192; *Public Trustee* v *Alder* [1922] 1 Ch 154; *Re Holland* [1928] SR NSW 369, 378, 379; *Miles* v *Official Receiver* [1963] ALR 620. See also *Meagher* paras 1111, 1112 and *Halsbury's* Vol 16 para 1427.

40 See Part IX above.

41 *Re Professional Life Assurance Co* (1867) LR 3 Eq 668, 680; *Re International Life Assurance Society* (1876) 2 ChD 476.

4 Both the multiply charged property and the singly charged property must have been charged in favour of the multiple chargee as security for the *same* debt.[42] For example:

(a) CHARGOR

Property X		*Property Y*	
Chargee A	(Charged as security for debt 1)	Chargee A	(Charged as security for debt 2)
Chargee B			

Two properties charged for different debts.

(b) CHARGOR

Property X		*Property Y*	
Chargee A	(Charged as security for debt 1)	Chargee A	(Charged as security for debt 1)
Chargee B			

Two properties charged for the same debt.

Marshalling will only operate in the second scenario. The doctrine cannot operate in the first scenario because there will be no surplus security under *Y* if A realises *X* to satisfy debt 1. In the first scenario B cannot be subrogated to the rights of A under *Y* because A still holds those rights; debt 2 is still to be satisfied.

The only exception to the "common debt" rule is a *Barnes* v *Racster*[43] type situation. For example:

(c) CHARGOR

Property X		*Property Y*	
Chargee A	(Charged as security for debt 1)	Chargee A	(Charged as security for debt 1 and debt 2)
Chargee B			

A charge is given over *X* in favour of A as security for debt 1; *X* is then charged in favour of B. Finally, *Y* is charged in favour of A as security for debt 2 *and* debt 1. Because *Y* is also security for debt 1, B is entitled to marshal against A's right under *Y once A has satisfied debt 2.*

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42 *Re O'Leary* (1985) 61 ALR 674.

43 (1842) 1 Y & CCC 401, 62 ER 944.

5 For marshalling to operate, the claim must be against the same chargor(s).[44]

The authority generally cited for this proposition is *Ex parte Kendall*.[45] In that case, there were five debtors who were jointly and severally liable for debts owing to certain creditors (A). There was also another set of creditors (B) seeking to recover debts owed by four of the debtors. These four debtors (1-4) became bankrupt and their creditors sought to marshal against the creditors of all five for the surplus security held over the solvent fifth debtor (5).

DEBTOR 1	DEBTOR 2	DEBTOR 3	DEBTOR 4	DEBTOR 5
A	A	A	A	A
B	B	B	B	

It was held that marshalling was not applicable in this case as the creditors' claims were against *different* debtors, rather than claims against the property of the *same* debtors.

It is accepted in New Zealand that there is only one exception to this, the "common debtor" rule.[46] The exception operates where B holds a charge over the property of CHARGOR 1, over which there is also a prior charge held by A, for which CHARGOR 2 is *principally liable*. Thus:

CHARGOR 1	CHARGOR 2
(Surety)	(Principal)
Chargee A	Chargee A
Chargee B	

In this situation, if A prejudices B's charge over the property of CHARGOR 1, B can marshal against any surplus security held by A over CHARGOR 2, because CHARGOR 2 is "principally" liable for the debt owed to A. It is in effect CHARGOR 2's debt.

The first of the two New Zealand authorities for this exception is *New Zealand Mercantile*.[47] In this case a mortgage over two properties was granted in favour of A (the multiple chargee). The two properties were owned separately by the principal and the surety. Later, the principal granted a second mortgage over its own property in favour of the claimant, B.

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44 *Carters* v *Tanners Leather Co* (1907) 81 NE 902; *New Zealand Loan and Mercantile Agency Company* v *Loach* (1912) 31 NZLR 292: *Re Taylor* [1934] NZLR 117; *Ernst Bros* (1921) 57 DLR 500; *Savings and Loan Corp* v *Bear* (1930) 154 SE 587; *Re Manawatu Transport* (1984) 2 NZCLC 99, 084. See also *Meagher* para 1109 and *Halsbury's* Vol 16 para 1427.

45 (1811) 34 ER 199, [1803-13] All ER Rep 295.

46 *New Zealand Mercantile and Loan* v *Loach* (1912) 31 NZLR 292; *Re Manawatu Transport* (1984) 2 NZCLC 99, 084.

47 *New Zealand Mercantile and Loan* v *Loach* (1912) NZLR 292.

CHARGOR 1	CHARGOR 2
(Principal)	(Surety)
Chargee A	Chargee A
Chargee B	

To the detriment of B, the multiple chargee satisfied its debt by realising its security over the land owned by the principal, CHARGOR 1. The claimant company, B, argued that, in the event of A satisfying its debt from CHARGOR 2, the surety, the right of the surety to be subrogated to the security held by A over the principal is inferior to the right of the single chargee, B, to have its debt satisfied by the principal. Therefore, the single chargee should be able to marshal against A's rights over the surety. However, the court held that if the multiple chargee, A, decides to enforce its right to payment from the principal, CHARGOR 1, B cannot marshal against the rights of A over the surety, because the surety is only *secondarily liable* for the debt. The surety can *only* be called upon by A to satisfy the principal's debt. In this situation, the surety is entitled to be subrogated to A's rights against the principal and this entitlement ranks ahead of B's.

The same decision was reached by Eichelbaum J in *Re Manawatu Transport*.[48] That case involved three companies in receivership with a dispute over the payment of debentures. The plaintiff company, UDC, applied to the court for a marshalling order to be subrogated to the rights of the two multiple chargees, BNZ and BP, against the sureties, Reliance and Wanganui.

MANAWATU	RELIANCE	WANGANUI
(Principal)	(Surety)	(Surety)
BNZ	BNZ	BNZ
BP	BP	
UDC		

Citing *Ex parte Kendall* Eichelbaum J stated:[49]

> [A]lthough the funds belong to different parties, the requirement of a common debtor is negatived where as between the owner of the fund charged once and the owner of the fund charged twice, there is an obligation on the former to bear the burden of all charges as between themselves.

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48 (1984) 2 NZCLC 99, 084.

49 Above n48, 99,088.

Further on he stated:[50]

> UDC wishes to throw the Bank of New Zealand on to Wanganui and Reliance, but the relationship of the latter two companies to Manawatu is not that of principal to surety, but of surety to principal. Thus ... there is no common debtor, and ... the facts ... are a *positive obstacle* to the applicability of marshalling.

The majority of the cases and texts[51] support the conclusion that *Re Manawatu* was correctly decided and that the principal/surety distinction still exists and is the only exception to the common debtor rule.

6 Another limitation unique to New Zealand is outlined in the Court of Appeal decision in *The King* v *The Westport Harbour Board*.[52] The Westport Harbour Board Act 1884 created a statutory fund to which the Board and the Crown could look to satisfy a certain debt. The Board also had its own assets from which it could satisfy the debt. It was, therefore, a situation where the Board (A) had two funds from which to satisfy the debt and the Crown (B) only one.[53]

BOARD FUND	STATUTORY FUND
A (Board)	A (Board)
	B (Crown)

Although this appears to be a classic situation where marshalling should apply, Williams J reasoned that when the statutory fund was created it was to be applied for the repayment of the two debts and that the Act[54] did not allow for the repayment of one, and then the repayment of the other. Accordingly, the doctrine of marshalling cannot over-ride the repayment of a debt pursuant to an Act.[55]

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50 Above n48, 99,088 (emphasis added).

51 Above n 44. This issue has been discussed at length because there are two cases that *Meagher* says contradicts the common debtor requirement (see para 1133). The first is *South* v *Bloxam* (1865) 2 Hem & M 457, 71 ER 541, where it was held that a single chargee *could* marshal against the multiple chargee's rights over the surety. As this case has almost identical facts to *New Zealand Mercantile* and there is no material fact that distinguishes the two cases, *South* v *Bloxam* cannot be taken as representing the present law. The second case is *In re Islip, ex parte Official Assignee* (1907) 26 NZLR 1293. Again, the court held that the single chargee, the Official Assignee, could marshal against property held by the bankrupt's wife, who was surety for the multiple chargee's debt. This case is, however, distinguishable on the basis that marshalling was only applicable because of the operation of a statute (s 5 of the Married Women's Property Act 1884). The effect of the statute was to make the wife's property part of the husband's estate for the purposes of bankruptcy, thereby making the wife "principally" liable for the debt to the multiple chargee and subject to marshalling claims.

52 (1905) 25 NZLR 449.

53 Above n52, 461.

54 Section 12 of the Westport Harbour Board Act 1884.

55 Above n52, 461.

VIII PRACTICAL APPLICATION OF THE DOCTRINE

This part outlines the practical application of the doctrine and some of the problems that arise as a result.

A Simple Marshalling

CHARGOR

Property X (Value $10)	*Property Y* (Value $10)	*Property Z* (Value $10)
Chargee A	Chargee A	Chargee A
(Value of charge to A $10)	(Value of charge to A $10)	(Value of charge to A $10)
Chargee B		
(Value of charge to B $15)		

In this example, the chargor has given a charge over *X*, *Y* and *Z* to A for $10, then a subsequent charge over *X* to B for $15. If A realises *X* to recover its debt, equity states that if there is insufficient security over *X* to satisfy B's debt B may marshal against the "surplus security" of A over *Y* and *Z*.

Prima facie, "surplus security" equals the total value of the charges over *X* and *Y* and *Z* ($30) minus the value of the depletion of the common security by A ($10), which equals $20. With access to $20 of surplus security, B can easily satisfy its debt of $15. However, marshalling seeks only to put the single chargee in the position it would have been in *"but for"*[56] the depletion of the common security by the multiple chargee. As A depleted the common security to the value of $10, B is only entitled to marshal against A over *Y* and *Z* to a maximum of $10. Therefore, if B's claim is successful B will be subrogated to the rights of A over *Y* and *Z* to the value of $10.

B Marshalling by Apportionment

CHARGOR

Property X (Value $10)		*Property Y* (Value $15)	
Chargee A	(Value of charge to A $10)	Chargee A	(Value of charge to A $10)
Chargee B	(Value of charge to B $15)		
		Chargee C	(Value of charge to C $15)

This is an example of two competing chargees. The chargor grants a charge over *X* and *Y* to A for $10, then a charge over *X* to B for $15 and finally a charge over *Y* to C for $15. As in the previous example, A realises *X* to satisfy its debt.

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56 T Schumacher "Marshalling - An Old Rule in a Modern World" (Aug 1989) Accountants' Journal 34.

Although equity cannot control the order of realisation of the properties by the multiple chargee, if by this realisation prejudice is caused to either single chargee, equity provides that A's debt is to be apportioned *notionally* between all the property to cause the least prejudice to all the single chargees.[57]

The apportionment of debt is relative to the respective values of the properties. For example A's debt of $10 is spread across *X* and *Y*, as follows:

Property X $\frac{\$10 \text{ (Value of } X) \times \$10 \text{ (Value of A's debt)}}{\$25 \text{ (Combined value of } X \text{ and } Y)} = \frac{\$100}{\$25} = \$4$

Property Y $\frac{\$15 \text{ (Value of } Y) \times \$10 \text{ (Value of A's debt)}}{\$25 \text{ (Combined value of } X \text{ and } Y)} = \frac{\$150}{\$25} = \$6$

Notional Apportionment:

Property X	$10	*Property Y*	$15
A	$4	A	$6
B	$6		
		C	$9

Real Apportionment:

Property X	$10	*Property Y*	$15
A	$10	A	$10 (B $6, C $4)
		C	$5

Therefore, B is entitled to $6 of the surplus security and C $4 plus $5 which is the remainder of *Y* once the surplus security is used up. This formula for marshalling will work in all situations although the equations may become more complex.

C The Rights of Subsequent Single Chargees

CHARGOR

Property X	$10	*Property Y*	$15
Chargee A	$10	Chargee A	$10
Chargee B	$15		
		Chargee C	$9
		Chargee D	$1

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57 *Barnes* v *Racster* (1842) 1 Y & CCC 401, 62 ER 944; *Bugden* v *Bignold* 2 Y & CCC 377; *Smyth* v *Toms* [1918] 1 IR 338; *Gibson* v *Seagrim* (1855) 20 Beav 614, 52 ER 741; *White* v *The London Chartered Bank of Australia* (1877) 3 VLR 33; *Ollivier* v *Colonial Bank* (1887) 5 NZLR 239; *Flint* v *Howard* [1893] 2 Ch 54; *Baglioni* v *Cavalli* (1900) 83 LT 500; *In re Crothers* [1929] VLR 49; *Victoria & Grey Trust Co* v *Brewer et al* (1971) 14 DLR (3rd) 28.

This example is the same as the previous one, except that C's charge is only for a value of $9 and there is a third charge over *Y* to D for $1. The calculations will be the same as in 2 because all the relevant figures, the value of *X* and *Y* and the surplus security, are the same.

Notional Apportionment:

Property X	$10	*Property Y*	$15
A	$4	A	$6
B	$6		
		C	$9
		D	$0

Real Apportionment:

Property X	$10	*Property Y*	$15
A	$10	A	$10 (B $6, C $4)
		C	$5
		D	$0

B is, therefore, entitled to be subrogated to $6 of the surplus security over *Y* and C is entitled to be subrogated to the other $4 of surplus security under *Y*. C is also entitled to the excess of $5 under *Y* to satisfy the rest of its debt. This leaves D with only a personal claim against the chargor for which there is now no security.

This situation where D's security interest is subject to B's right to marshal is consistent throughout the case law.[58] B is considered on an equal footing with C and superior to D as to the entitlement to the surplus security. Only once A's charge been apportioned rateably and C's debt has been satisfied does D have any entitlement to *Y*. In other words, D's entitlement to *Y* is unprotected from and subject to B's right to marshal against the surplus security over *Y*. Clearly, this is very much to the detriment of a single chargee in D's position. It denies D protection as a secured creditor against persons without a prior secured interest in the property.

The argument offered in favour of denying D this protection is that D knew its interest was subject to the prior claim of A and, by giving B access to this prior claim, B's claim is not prejudicing D's claim any more than it could have been prejudiced by A exercising its full rights of realisation over *Y*.[59] If A had satisfied itself out of *Y* to the full amount of its debt D would be in the same position.

D Commercial Use of Marshalling

Marshalling seeks to protect those who have an interest in property from the prejudicial realisation of that property by a prior claimant. If used properly, the doctrine

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58 Above n57.

59 Above n1, 693,694.

of marshalling will almost guarantee payment of a debt, even in a situation where the security is "over secured".

For example:

Property X	$100	*Property Y*	$200
Chargee A	$100	Chargee A	$100

In this example there are two properties, *X* valued at $100 and *Y* valued at $200. There is also a charge over both to A for $100. If the chargor then approaches a financier, B, hoping to raise capital, but is unwilling to permit another charge over *Y*, the financier may take a charge over *X* and feel reasonably confident of recovering its debt, even though *X* is already fully secured, ie debts against *X* equal its value. By calculating the amount of surplus security that it would be entitled to in the event of A depleting *X*, B can calculate the amount it is safe to lend the chargor. In other words, presume the chargor charges *X* in favour of B and *Y* in favour of C and, later, A satisfies its debt from *X*. To what extent is B entitled to be subrogated to the surplus security over *Y*?

Property X $\frac{\$100 \text{ (Value of } X\text{)} \times \$100 \text{ (Value of A's debt)}}{\$300 \text{ (Value of } X \text{ and } Y\text{)}} = \frac{\$100}{\$3} = \$33$

Property Y $\frac{\$200 \text{ (Value of } Y\text{)} \times \$100 \text{ (Value of A's debt)}}{\$300 \text{ (Value of } X \text{ and } Y\text{)}} = \frac{\$200}{\$3} = \$67$

Notional Apportionment:

Property X	$100	*Property Y*	$200
A	$33	A	$67
B	$?		

B's entitlement:

$100	(Value of *X*)
− $33	(A's debt apportioned to *X*)
= $67	(Maximum value of B's entitlement to the surplus security)

Regardless of the fact that *X* is already fully secured, B can take a charge over *X* up to a value of $67 and feel reasonably confident of recovering its debt. This is the value of surplus security that B is entitled to be subrogated to should A deplete *X*.

This entitlement is subject only to two exceptions. The first arises where A releases *Y* as security for its debt, in which case B has nothing to marshal against. It is not common for a multiple chargee to do this, but it *can* happen. The second exception arises from the fact that marshalling is not an *enforceable right*; it is merely a *remedy* which the court in its discretion may award.[60]

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60 See Part VI C above.

IX MARSHALLING IN RELATION TO THIRD PARTIES

One of the many limitations of marshalling highlighted earlier is that marshalling will not operate to the prejudice of third parties.[61] The scope of the limitation, particularly in relation to unsecured creditors and volunteers, is discussed herein.

A *The Protection of Third Parties*

The authority generally cited for the broad proposition, that marshalling will not operate to the prejudice of third parties, is the 1870 decision of the House of Lords in *Dolphin* v *Aylward*.[62] The facts of the case are reasonably complex, but the basic position, for our purpose, is as follows.

Property X	*Property Y* ----- B
Chargee A	Chargee A
Chargee C	

First, the settlor made a voluntary settlement of *Y* on trust to B, his family. However, by virtue of a statute, the settlor was able to defeat the trust created for his family, and grant a mortgage to A over *X* and *Y*.[63] Later C became a judgment creditor with an entitlement to the equity of redemption of *X*. The settlor then defaulted on the mortgage, so A realised *X* to satisfy its debt. C then sought to marshal against A's rights over *Y*. The House of Lords held that C was only entitled to the same rights to *Y* as the settlor possessed when C became a judgment creditor.[64] As the settlor had no rights or claims against the settled property, C could not acquire any either and marshalling was held to be inapplicable to this situation.

The decision itself is no doubt correct. Title to *Y* was validly transferred to B and it was only by reason of the operation of a statute that the settlor was able to mortgage *Y* in favour of A. B should not then be further prejudiced by permitting C to marshal against A's rights over *Y*, even though B is a volunteer.

There are, however, problems with dicta in the case. During the course of his decision the Lord Chancellor, Lord Hatherley, discusses a hypothetical, in which the order of events in *Dolphin* v *Aylward* is varied.

Property X	*Property Y* ----- B
Chargee A	Chargee A
Chargee C	

First, the settlor grants a mortgage over *X* and *Y* in favour of A, *Y* is then settled on B and, finally, a second mortgage over *X* is granted in favour of C.

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61 See part VII 2 above.
62 (1870) LR 4 HL 486.
63 Above n62, 499.
64 Above n62, 503.

Of this hypothetical Lord Hatherley stated:[65]

> I apprehend that [C] cannot ... affect the interests created in third parties by the doctrine of marshalling, that is to say, [C] cannot throw the mortgage [over *X*] upon [*Y*], the estate conveyed away by the voluntary settlement, in order that [C] may leave [*X*] entirely clear and free from mortgage debt.

Contrary to this dictum is the 1910 Supreme Court decision of Williams J in *Re Stephenson*.[66]

> A man mortgages two properties. Subsequent to the mortgage he makes a voluntary conveyance of the equity of redemption of one of them. In this conveyance there is no covenant on his part to pay off the mortgage or to indemnify the transferees from it, nor any indication of any intention to make over the property to the transferees discharged from the mortgage. The equity of redemption is all that is conveyed. The position is the same as where a man has mortgaged his property and afterwards sells the equity of redemption or part of it to a third person ... There is no bargain, express or implied, on the part of the vendor that the burden should be thrown upon his part of the property. *If there is an equity ... it is only that the burden of debt should be borne in proportion to the value of the properties.*[67]

In *Re Stephenson* Williams J makes a clear distinction between a transfer of title and a transfer of the equity of redemption. It appears that where *title* is transferred, the transferee is protected from marshalling claims by the "common debtor rule", because the claim is no longer against the property of the *same* debtor, ownership in the property having passed to a third party. However, where only *the equity of redemption* is transferred, the situation is analogous to the grant of a second mortgage. For example:

(1)	*Property X* Chargee A Chargee C	*Property Y* ----- B Chargee A	(2)	*Property X* Chargee A Chargee C	*Property Y* Chargee A Chargee B

In examples (1) and (2) the chargor grants a mortgage over *X* in favour of A. Under the mortgage title is transferred to A and the mortgagor retains the equity of redemption. In example (1) this is then transferred to B. However, in example (2) the equity of redemption is transferred to B by way of a second mortgage. Finally, in both examples, a mortgage of the equity of redemption of *X* is granted in favour of C.

In example (2), B and C compete equally for any surplus security. However, in example (1) B is exalted to a position where it is not only protected from any marshalling claims by C, but can also marshal to the prejudice of C. In both examples,

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65 Above n58, 501.
66 (1910) 30 NZLR 145.
67 Above n66, 146 (emphasis added).

ownership is retained by A, and B is only entitled to the equity of redemption. Given the similarity, it is arguably unjust for B to attain this special protection in example (1), particularly if B is a volunteer.

Probably the best interpretation of the cases is that *only transferees of title* to the charged property are third parties deserving of protection against marshalling claims. Under this analysis, transferees for value of *the equity of redemption* compete equally with single chargees for any surplus security and volunteers stand unprotected against the marshalling claims of single chargees. It must be remembered that marshalling is an equitable remedy and equity does not generally protect or afford remedies to volunteers. In fact this is the position taken by the Irish courts[68] and by the Master of the Rolls, Sir John Leach, in *Lomas* v *Wright*.[69] In that case he held that a mere volunteer is "*not* entitled to compete with creditors ... for valuable consideration" but only against other volunteers.[70]

If, however, this analysis is incorrect, the literal application of *Dolphin* v *Aylward* will mean that any person who takes a transfer of the chargor's interest, whether it be the title or some lesser interest, is protected from the marshalling claim of any single chargee whose charge was granted after[71] that transfer.

B Volunteers and Testamentary Dispositions

From the discussion above, it is evident that the law in relation to third parties who take by reason of *inter vivos dispositions* is not yet settled. It is clear, however, that third party *volunteers*, who take by reason of *testamentary dispositions*, are not third parties deserving of protection from marshalling claims.[72]

The first of the New Zealand authorities on this point is *In re Tremain*.[73]

Real Estate	*Policies* ----- Wife
Bank	Bank
Creditors	

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68 *Ker* v *Ker* (1869) 4 IR Eq 15.

69 (1835) 2 My & K 769, 39 ER 1138.

70 Above n69, 774, 1140 (emphasis added).

71 Notice of prior charges is immaterial to claims of marshalling by apportionment and this seems to indicate that transferees take subject to the marshalling claims of single chargees whose charges were granted *before* the transfer: *Aldrich* v *Cooper* (1803) 3 Ves Jun 392, 390, 32 ER 402, 408; *Gibson* v *Seagrim* (1855) 20 Beav 614, 52 ER 741, 743; *Flint* v *Howard* [1893] 2 Ch 54, 72, 73; and *Smyth* v *Toms* [1918] 1 IR 338, 346, 347.

72 *Hughes* v *Williams* (1852) 3 Mac & G 683, 41 ER 423; *Re Darby's Estate* [1907] 2 Ch 465; *In re Ainge, Wheeler* v *Bank of Australia* [1935] NZLR 691; *In re Watkins, Guardian Trust and Executors Co* v *Watkins* [1938] NZLR 847; *In re Coote, Coote* v *Public Trustee* [1939] NZLR 757. See also *Bisset* v *Australia and New Zealand Bank Ltd* [1961] NZLR 687.

73 *In re Tremain, Tremain* v *Public Trustee* [1934] NZLR 369.

A testator charged a life insurance policy and some real estate in favour of a bank. By his will be bequeathed the proceeds of the policies to his wife (a volunteer). At his death the bank realised the policy in satisfaction of its debt. Unsecured creditors of the deceased then sought to satisfy their debts from the real estate. The wife, however, attempted to marshal against the bank's rights to the real estate, to recover some of what was lost from the policy. The Court of Appeal found that apart from one decision of the Supreme Court of Victoria,[74] the doctrine of marshalling had not been applied in favour of a chargor or its representative as against its creditors. Of the Victorian decision, MacGregor J said that it was not a "safe or authoritative guide".[75] Therefore, the wife was unable to marshal against the general creditors.[76]

A similar case is *In re Coote, Coote* v *Public Trustee*.[77]

General Assets	*Policies* ----- Wife
Bank	Bank
Creditors	

In this case, the bank realised the general assets of the deceased's estate to satisfy its debt. Because of this depletion the creditors were not able to satisfy their debts. They therefore attempted to marshal against the surplus security held by the bank over the policies. Reed J in the Supreme Court held that the creditors were unable to succeed, but *only* by reason of section 65 of the Life Insurance Act 1908,[78] which prevented life insurance policies from being available for the satisfaction of creditors. However, in a later case involving similar facts, *Bisset* v *Australia and New Zealand Bank Ltd*,[79] the Court of Appeal held that section 65 will not prevent a marshalling claim by unsecured creditors from succeeding:[80]

> Where a debtor simply assigns the whole of his estate to creditors, he is clearly protected by s 65 as to ... his life policy; but ... [i]n the present case, he has abandoned it to the extent of the amount of the Bank's debt and has by his own deliberate act made it amenable to the Bank's claim. If therefore another creditor is able in equity to require the Bank to have recourse to this fund (which the debtor by his own act has made amenable to the Bank's claim) no injustice appears to be done, nor is the purpose of the statute in any way offended ... *Marshalling is a doctrine which enables a person who has no security in law or equity against [an] asset ... to become subrogated to such a claim, if the creditor entitled to resort to this and other assets by his election deprives him of his security.*

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74 *In re Crothers* [1929] VLR 49.

75 Above n69, 388.

76 Note the similarity between this situation and that in *Dolphin* v *Aylward* (1870) LR 4 HL, above n62, but the different result.

77 [1939] NZLR 457.

78 The section was repealed by section 4(9) of the Life Insurance Reform Act 1985 and has not been replaced.

79 Above n1.

80 Above n1, 693, 694 (emphasis added).

This may or may not be the low water-mark for volunteers' protection. In any event, as regards testamentary dispositions, the cases appear to lay down a set of priority rules. First, a volunteer stands unprotected against the marshalling claims of people with a bona fide entitlement for value against the debtor and secured creditors. Secondly, people with a *bona fide* entitlement against the debtor stand unprotected against the marshalling claims of *secured* creditors.[81]

X COVENANTS PREVENTING MARSHALLING

Although a single chargee may apply to a court to marshal against a multiple chargee for any surplus security, there are various ways of preventing this. This is generally achieved by incorporating "covenants preventing marshalling" into the relevant security agreement. This section of the paper discusses some of these covenants and their varying success.

A Protecting the Chargor

a) A security agreement may require the *single chargee* to covenant not to marshal. This prevents the single chargee from being granted access to securities to satisfy its debt other than those securities specifically identified in its security agreement. For example:

Property X	*Property Y*
Chargee A	Chargee A
Chargee B	

Such a covenant preventing the single chargee, B, from marshalling ensures that, should A realise *X* to satisfy its debt, B is unable to marshal against any surplus security over *Y*. "The difficulty ... lies in persuading a single chargee to agree to be at the mercy of the multiple chargee with regard to the order of realisation of securities."[82]

b) The simplest and most effective way of preventing marshalling, from the point of view of the chargor, comes from the first of the limitations to marshalling outlined in Part VII above, that is, "no right to marshal exists where the multiple chargee does not have equal recourse to each security to satisfy its debt".[83] For example:

Property X	*Property Y*
Chargee A	Chargee A
Chargee B	

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81 In this situation, a "single chargee" is a person with a *secured interest* in the debtor's property.

82 T Schumacher "Marshalling - An Old Rule in a Modern World" (Aug 1989) Accountants' Journal 34, 36.

83 See Part VII above.

A's security agreement with the chargor may require that A only satisfy itself from *Y* if *X* is deficient. In the absence of a provision of this kind, A would be entitled to satisfy itself from either *X* or *Y* and, if this depleted *X*, B could marshal against any surplus security over *Y*. But if A is only entitled to resort to *Y* to satisfy its debt to the extent that *X* is deficient, then once A's debt is satisfied any right to seek recourse to *Y* is extinguished and B has nothing to be subrogated to. A single chargee's right to marshal is, therefore, only against surplus security over property to which the multiple chargee has a *first right of recourse*. This situation is analogous to the principal/surety situation where a single chargee can only marshal against the security of the principal, the person against who there is the first right to recourse.[84]

This is arguably the most effective way for a chargor to prevent marshalling by single chargees. It is more effective than (a) for two reasons.

1 Under (a), the chargor must negotiate with the single chargees to agree not to marshal, whereas under this option negotiation is with the multiple chargee.

2 There will normally be no problem in requiring the multiple chargee to agree to seek recourse from one security before another, because this does not affect the multiple chargee's prior and paramount claim, nor does it affect the total value of the property subject to its security agreement with the chargor.

B Protecting a Multiple Chargee

A multiple chargee might require the chargor to covenant, in its favour, that if any subsequent security agreement is granted over any property over which the multiple chargee has security, that agreement will itself contain a covenant by the *subsequent chargee* not to marshal. The multiple chargee seeks in this fashion to avoid the risk that a single chargee's right to marshal might interfere with its ability to realise the properties in any chosen order. This risk is more imaginary than real. Marshalling does not interfere with a multiple chargee's right to realise the securities. It is not a preventative doctrine. It remedies the prejudicial acts of a multiple chargee and generally will not restrain the multiple chargee in any way.[85] This covenant against marshalling is really only of use to a multiple chargee in cases where it has an interest in protecting the surplus security of the chargor. For example:

Property X	*Property Y*
Chargee A	Chargee A
Chargee B	

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84 See limitation 5, Part VII above.

85 See Part IV above.

If A seeks to satisfy its debt, the chargor might persuade A to realise in such a manner as to defeat B's charge and preserve *Y*. A might be a friend, a relative, a subsidiary or a parent company of the chargor.

Such a covenant by B not to marshal against any surplus security held by A will, generally, protect A from the marshalling claims of B, but it is unclear what protection, if any, it will provide if there is evidence of bad faith on A's part.[86]

C Protecting the Single Chargee

a) A security agreement sometimes contains a covenant *by the chargor* that it will not marshal in its own favour. This covenant is meaningless. Marshalling is an equity that belongs to single chargees. A chargor cannot marshal in its own favour even if it so desired.

b) Another potentially useful covenant against marshalling is where a *single chargee* requires the chargor to covenant that if any subsequent charges are granted over any property already charged by a multiple chargee, then that subsequent chargee must itself covenant not to marshal. For example:

Property X	*Property Y*
Chargee A	Chargee A
Chargee B	
	Chargee C

The chargor charges *X* and *Y* in favour of A and then wishes to borrow further money. Financier, B, agrees to lend money on the basis of a charge over *X* and a covenant by the chargor that, if any subsequent charges are granted over property already charged by the multiple chargee, A, then such chargees must covenant not to marshal against any surplus security held by A.

If the chargor requires such a covenant of C, the effect of it will be two-fold.

1 It will protect B against any marshalling claim of C in the event of A realising *Y* to satisfy its debt, because C has contracted out of any rights to marshal against surplus security held by A; and

2 It will permit B to marshal against C on an equal footing in the event of A realising *X* to satisfy its debt, ie marshalling by apportionment.[87]

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86 See Part IV above for a discussion of the liability on multiple chargees who transfer property in bad faith and of third party transferees who take with notice of this bad faith.

87 Because B is not subject to a similar covenant it can still marshal against any surplus security held by A over *Y*.

In all, there are some very effective ways of preventing marshalling and should marshalling become more prominent, this is likely to be the largest growth area in respect of legal developments.

XI OUTSTANDING PROBLEMS

As an equitable doctrine marshalling is till in its infancy and therefore there are still some unresolved conceptual problems. This section of the paper looks at these problems and suggests some solutions.

A Problem 1

Property W	*Property X*	*Property Y*	*Property Z*
Chargee A	Chargee A	Chargee A	Chargee A
	Chargee B	Chargee B	
	Chargee C		Chargee C
	Chargee D		

In this example a first, second, third and fourth charge exist over property *X* in favour of A, B, C and D, respectively. A also has a first charge over *W*, *Y* and *Z*, B a second charge over *Y* and C a second charge over *Z*. If A, B and C decide to realise *X* to satisfy their debts and there is insufficient to satisfy D's debt, D is able to marshal. But unlike other earlier examples, where there is only one person against whom to marshal, here there are three multiple chargees, A, B and C. The question here is, against whom can or must D marshal first? This question is particularly important to the chargor where the properties have an appreciating or depreciating value. It is arguable that A or C should be marshalled against first, A being the first to prejudice *X* and C the last. However, the point is yet to be raised in the courts and basic principles of marshalling are of no help.

A similar problem arises in the following example:

Property W	*Property X*	*Property Y*	*Property Z*
Chargee A	Chargee A	Chargee A	Chargee A
	Chargee B		

In this example, a first charge to A is granted over *W*, *X*, *Y* and *Z*. Then a second charge is granted over *X* in favour of B. In the event that A realises *X* to satisfy B's debt, what restrictions, if any, are there on B in choosing which property to marshal against to satisfy its debt?[88]

When the chargor grants a charge in favour of A, it abandons its right to have the first and foremost claim to the property and it has been said that there is then no

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88 This issue should not be confused with the earlier discussion of the "notional" apportionment of the multiple chargee's debt between the securities. This issue involves the "actual" realisation of the securities. See Part VIII B above.

prejudice in allowing the single chargee access to the surplus security.[89] It could be argued that the single chargee should be allowed to realise whatever property it chooses. A better view is that the chargor abandons this right to the first claim to the property *only* in respect of the multiple chargee to whom the charge is originally granted. Because marshalling is an equitable remedy and not a proprietary interest,[90] where there is more than one security from which the single chargee can satisfy its debt, the chargor and *not* the single chargee should have the right to determine which property will be realised. Applying this to the example given above, the chargor will determine which property or combination of properties is to be realised to satisfy B's debt.[91]

B Problem 2

Property X	*Property Y*
Chargee A	Chargee A
Chargee B	

This example is similar to some of the previous examples of marshalling, except that instead of the chargor breaching the security agreement with the *multiple chargee*, A, the chargor breaches it with the *single chargee*, B, who then exercises a power of realisation over *X*. The unresolved question is whether B can marshal against any surplus security under *Y* if A satisfies its debt from *X*. The authors of *Meagher* see this as a problem because it is the single chargee, B, and not the multiple chargee, A, who has exercised the power of realisation.[92] A better view is that the single chargee is entitled to marshal regardless of who exercises a power of realisation. The act of the multiple chargee in deciding from which security to satisfy its debt is the *crucial act* which creates a marshalling right. Where A has only just realised *X* and *Y* and has not decided from which security to satisfy its debt there has been no prejudicial act of the multiple chargee for equity to remedy. It is not until A decides from which security it will satisfy its debt that the single chargee can claim a marshalling right. If, however, the courts decide that the exercise of the power of realisation by the single chargee disentitles it to marshal, then the only means for a single chargee in B's position to gain access to the surplus security is to buy out A and then realise the securities and satisfy A's debt in a manner that causes the least prejudice to B's security, *X*.[93] B is in effect consolidating the charges. This action requires the multiple chargee's agreement and may not be permitted by the security agreement. It may even be illegal.[94]

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89 Above n1, 693. See also Part IX B above.

90 See Part IV above.

91 Note that this proposition is only possible where the chargor has retained all the interest to the securities and has not transferred any interest to a third party voluntarily or for value. In this situation, there will be competing interests and marshalling by apportionment may be applicable. See Part IX above.

92 *Meagher*, para 1135, 1136, 1137.

93 *Thorne* v *Cann* [1895] AC 11; *Whiteley* v *Delaney* [1914] AC 132; *Ghana Commercial Bank* v *Chandiram* [1960] AC 732.

94 The consolidation of mortgages is prohibited by section 85 of the Property Law Act 1952.

XII CONCLUSION

Even though the origins of the doctrine can be traced back to the mid-eighteenth century, marshalling is still undeveloped. There are as few as thirteen decisions on marshalling in New Zealand. Therefore, the unresolved issues in this area are likely to remain unresolved for some time. In practice, marshalling should not give rise to problems of enforcement as multiple chargees will generally have no reason to resist a marshalling claim: a multiple chargee's interest is prior and paramount and unaffected by marshalling claims against the surplus security that it holds. The most serious problem facing a single chargee may well be that it will not know that a prior chargee is a "multiple chargee" and has other securities from which to satisfy its debt. This problem is one of "disclosure" in that a prior chargee is under no obligation to disclose to a subsequent chargee that there is other property against which it may seek to marshal should the prior chargee satisfy its debt from common property. It is possible that this lack of disclosure is one of the reasons why marshalling claims are so scarce and that marshalling's far-reaching application is not being fully utilised, particularly in the wake of the recent stock market crash and the resulting company and personal bankruptcies. Perhaps increased awareness of the doctrine's potential will remedy this situation.