# Bank of Tonga v 'Alatini & Muti

Court of Appeal
Martin CJ and Morling and Quilliam, JJ
Appeal No.16/1991

3,7 June 1991

*Contract - equitable charge - rights to enforce*
*Enforcement - judgment by distress*
*Judgment - enforcement by distress - goods still subject to equitable charge*

In June 1988 'Alatini (now deceased) obtained a judgment against Muti. The first respondent, his administratrix, enforced the judgment by the bailiff seizing chattels, including a van. Muti applied to Supreme Court for release of the goods on the basis:

(i) they were jointly owned by him and his wife; and
(ii) they were subject to a security in favour of the appellant Bank and that the bailiff could not give title to a purchaser whilst the security remained undischarged.

Webster J. dismissed the application ([1990] Tonga L.R.1) and refused leave to appeal.

The Court of Appeal granted leave to appeal ([1990] Tonga L.R. 153), and two issues were argued, viz;-

(i) whether the security agreement gave the appellant an equitable interest in the chattels; and,
(ii) whether the seizure by the bailiff deprived the appellant of it's interest in the chattels.

HELD

(1) That the security agreement did not create a pledge, may have created an equitable mortgage but that did not have to be determined finally because it did create an equitable charge and the appellants rights to enforce it's security over the chattels would be the same whether the security was an equitable mortgage or an equitable charge;
(2) The mere seizure of the chattels by the bailiff did not affect the appellant's equitable interest. The bailiff took possession subject to whatever charges, legal or equitable, which affected them.

Statutes considered:
Contract Act (Cap.26) ss.5 and 6

Laws Consolidation Act s.11
Magistrates' Courts Act s.53

Cases referred to:
Reeve v Whitmore (1863) 33 L.J. C.R.63
Proctor v Nicholson (1835) 7 C.& P. 67
The James W. Elwell [1921] P.351
re Bristow [1906] 2 I.R. 215

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| Counsel for appellant | : | Mr Hogan |
| Counsel for first respondent | : | Mr Niu |
| Counsel for second respondent | : | Mr Tonga |

**Judgment**

On 29 June 1988 Vakapuna 'Alatini obtained a judgment in the Supreme Court of Tonga in the sum of $24,600 plus interest against Paula Muti. Mr 'Alatini died before the judgment was satisfied and after his death the first respondent who is the administratrix of his estate took steps to enforce the judgment. At her instigation the bailiff of the Court seized certain chattels, including a Toyota Hiace motor vehicle, which were believed to be owned by Mr Muti. Before the chattels were sold by the bailiff an application was made to the Court by Mr Muti for their release on the ground that they were not his or, alternatively, were jointly owned by him and his wife. He further claimed that the chattels were subject to a security in favour of the Bank of Tonga and that the bailiff could not give title to a purchaser of them whilst the security remained undischarged.

When the application came before the Court, the Bank of Tonga appeared and supported Mr Muti's application for the release of the chattels. Webster J dismissed the application (see [1990] Tonga L.R.1). The bank failed to appeal within time against Webster J's decision. However the Court of Appeal subsequently gave leave for an appeal to be brought out of time upon the bank undertaking that it would not seek to enforce its rights under its security in priority to the rights of the first respondent and upon it further undertaking that it would pay the first respondent's costs of the appeal irrespective of its outcome (see [1990] Tonga L.R. 153).

In substance, there were two issues before Webster J so far as the bank's rights were concerned. The first question was whether the Agreement gave the bank an equitable interest in the chattels. The second question was whether the seizure of the chattels by the bailiff had the effect of depriving the bank of its interest in the chattels as against the bailiff or a purchaser from him.

In the proceedings before Webster J a number of issues arose as to some items of property seized by the bailiff but in which the bank claimed no interest. The orders made by the learned judge in respect of those items have not been challenged on appeal and we are therefore not concerned with them.

The security relied upon by the bank is a Loan Agreement made on 19 December 1989. The Agreement refers to the amount borrowed and the terms of repayment of the loan and contains the following provisions:

"The Borrower pledges the following articles as security for the performance of this

Agreement:

Dwelling house at Ha'ateiho and contents and Hiace Toyota L1003

and the Borrower agrees to preserve carefully the said articles hereby pledged as security. And the Borrower further agrees that he will not give away sell of otherwise dispose of the said articles until he has received from the bank a signed memorandum stating that the terms of this Agreement have been performed.

In the event of failure by the Borrower to fulfil his obligations under this Agreement then the balance owing becomes payable on demand and the bank is entitled to take possession of the said articles pledged as security without further process of Law and the borrower undertakes to give up control of the said articles on demand by the Bank."

Before Webster J a question arose as to whether the motor vehicle seized by the bailiff was identical with the vehicle referred to in the Agreement. It appears that at the time it was seized the vehicle bore a registration number different from the number referred to in the Agreement. In view of theundertaking given by the bank nothing turns on this point. The purpose of the appeal is to obtain a judicial determination as to the effect, if any, of thesecurity given to the bank over property referred to in the Agreement. We shall therefore assume that the motor vehicle seized by the bailiff was identical with the motor vehicle referred to in the Agreement.

We were informed that the Agreement is a common form used by the bank and that it is common for borrowers to offer motor vehicles as security for loans made to them.

It should be said at the outset that the Agreement is cast in singularly inappropriate terms to give security over property of which the bank does not take physical possession. According to its terms, the borrower "pledges" articles as security for the performance of the agreement. A pledges of chattels is effected by delivery of possession to the creditor, subject to a condition that he will return the chattels when his claim under the pledge has been satisfied: see Waldock, The Law of Mortgages, 2nd ed., p.6. A pledge is incomplete without actual or constructive delivery of the thing pledged: Halsbury, Laws of England, 4th ed., Vol.32, para.412 and Vol.36, para.103, Skyes, The Law of Securities, 4th ed. 64g

It is plain from the terms of the Agreement that it was the intention of the parties that the borrower should retain possession of the chattels. Indeed, the borrower was obliged by the Agreement to "preserve carefully" the chattels as security for the loan. If the chattels had been pledged to the bank, they would not have been left in the borrower's possession. Hence the terms of the Agreement were inappropriate to carry into effect the intention of the parties, if their intention was to create a pledge. Indeed, it was conceded by counsel for thebank that there was no effective pledge of the chattels referred to in the Agreement because of the failure of the bank to take possession of them.

Before considering the legal effect of the Agreement it is necessary to ascertain the intentions of the parties to it as disclosed in the words they used. It should be observed that the wording of the Agreement follows the form set out in the Schedule to the Contract Act. No doubt this form of wording was adopted because of the provisions of ss.5 of 6 of that Act which require that a contract for, inter alia, the loan of money shall be in the form contained in the Schedule "with such modifications as circumstances require." It is reasonable to infer that the bank felt constrained to follow generally the words of the form contained in the Schedule when drawing the Agreement, lest it fail to comply with the requirements of ss.5 and 6.

It should also be observed that the Agreement is written in both the English and Tongan languages. This circumstance is of some importance since there is not an exact correspondence between the meaning of the English word "pledge" and the meaning of the Tongan words "tuku mai" which are used in the Agreement as synonymous with "pledge". According to Churchward's authoritative English - Tongan Dictionary "tuku mai" translates to "give to; release to". According to the same dictionary the Tongan words for "pledge" are "tukupa; palomesi; tohi fakapapau". None of those last-mentioned words appear in the Agreement.

It is true that s.11(2) of the Laws Consolidation Act provides that in the event of any doubt arising with respect to the meaning of any passage in the Revised Edition (in which the Contract Act appears), or of any difference existing between the English text and the Tongan text of any such passage, the English text shall be held to give the true meaning of such passage. But, as we have observed, s.6 of the Contract Act permits an agreement to be made "with such modifications as circumstances require". It seems to us that the parties to the Agreement, by using Tongan words slightly different in meaning from the word "pledge", modified the form in the Schedule. That is to say, they agreed that the chattels referred to in the Agreement should be "given to" or released to" the bank as security for the loan. We think it is demonstrated that the parties did not intend to create a pledge since they did not contemplate that the bank would take possession of the chattels, at least until such time as default was made in repaying the loan.

This is thus not a case where there is a difference between the English and Tongan texts of a section of an Act as contemplated by s.11 (2) of the Laws Consolidation Act. Rather this is a case where the parties have modified the English text of the Schedule and used Tongan words to more accurately reflect their agreement.

Webster J held that although the Agreement purported to the a pledge, it could not operate as such because a pledge is incomplete without actual or constructive delivery of the thing pledged. We agree with this Honour's conclusion in this respect and as we have already observed, it was not challenged by counsel for the bank.

However, it was submitted to Webster J that the Agreement, properly construed, gave the bank an equitable mortgage over the chattels said to be pledged "as security" for the performance of the Agreement. His Honour upheld this submission but his finding in this respect was challenged by the respondent.

On the hearing of the appeal counsel for the bank submitted that even if the Agreement did not operate as an equitable mortgage it nevertheless gave rise to an equitable charge which, for present purposes, gave the bank the same security as would be given by an equitable mortgage.

It is not always easy to distinguish an equitable mortgage from an equitable charge, and in many of the decided cases the interest of an equitable mortagee is referred to as an equitable charge. See Waldock, supra, at p.13-14 where the author describes the difference between an equitable mortgage and an equitable charge as "mainly formal".

The distinction between the two forms of security is academic for present purposes, since the bank's rights, if any, to enforce its security over the chattels will be the same whether the security be an equitable mortgage or an equitable charge.

A contract to give a legal mortgage of chattels, whether it arises from an express agreement to do so or impliedly from an informal attempt to give a legal mortgage gives rise to an equitable mortgage: Sykes, supra, at p.540.

Were it not for the meaning of the Tongan words "tuku mai" we would have thought the better view of the Agreement is that it created an equitable charge rather than an equitable mortgage. But if the Tongan words are adopted as disclosing the true intention of the parties there is much to be said for the view that the Agreement was an informal attempt by Muti to mortgage ("give" or "release") to the bank the relevant chattels as security for the loan made to him. On the other hand, it has to be said that the absence of any words in the Agreement requiring the bank to "give" or "release" the chattels back to Muti upon repayment of the loan are inconsistent with it being an informal attempt to give a mortgage. Counsel for the bank submitted that, reading the Agreement as a whole, the Court should imply a promise by the bank to release its interest in the secured chattels upon repayment of its loan. We think there is some force in this submission, but we do not need to reach a firm conclusion on it since we are of the opinion that, on any view of the Agreement, it created an equitable charge over the chattels.

An equitable charge is a security whereby, "without any transfer of, or agreement to transfer, ownership or possession, property is appropriated to the discharge of a debt": Cheshire, Modern Law of Real Property 11ed. 635.

The nature of a charge is described in the following terms in Goode, The Nature and Forms of Consensual Security p.14.

> "The charge does not depend on either the delivery of possession or the transfer of ownership, but represents an agreement between creditor and debtor by which a particular asset or class of assets is appropriated to the satisfaction of the debt, so that the creditor is entitled to look to the asset and its proceeds to discharge the indebtedness, in priority to the claims of unsecured creditors and junior incumbrancers. The charge does not transfer ownership to the creditor, it is merely an incumbrance, a weight hanging on the asset which travels with it into the hands of third parties other than a bona fide purchaser of the legal title for value and without notice. The charge is the creature of equity."

In our opinion it is plain from the Agreement that the chattels referred to in it were appropriated by the borrower, Muti, to the satisfaction of thebank's debt so that the bank became entitled to look to these chattels as security for its debt. The use of the words "as security for the performance of the Agreement" makes this clear. Accordingly, even if the Agreement did not amount to an equitable mortgage it nevertheless gave rise to an equitable charge.

Counsel for the respondent referred us to a number of cases which, in his submission, supported his argument that the Agreement did not give rise to an equitable interest of any kind. We think all of the cases he cited are distinguishable. We need mention only one - Reeve v Whitmore (1863) 33LJ CR. 63. It was there held, on the special facts of the case, that an assignment of existing chattels, coupled with words which amounted to a mere licence to seize after - acquired property did not operate as an equitable assignment of the after acquired property. But the facts of the case were quite different from the facts of the present case. In the present case the chattels were in existence at the time of the making of the Agreement and the terms of the Agreement itself make it clear that the borrower gave the chattels as security for the loan made to him.

We turn now to consider the second question which arises in the appeal i.e. the effect on the bank's rights of the seizure of the chattels by the bailiff. Webster J held that the

bank's sole remedy was to enforce its security against the borrower. He was of the opinion that the bank had no rights as against a third party such as the administratrix of Mr 'Alatini's estate who had caused the chattels to be seized by the bailiff under a court order.

If the chattels had been sold by the bailiff to a bona fide purchaser without notice of the bank's interest in them we would agree that the purchaser would have obtained a good title to the goods and that the bank's interest in the chattels would have been lost. But, as we understand the facts of this particular case, the chattels were not sold by the bailiff before the bank gave notice of its interest in them. In these circumstances, we do not think that the mere seizure of the chattels by the bailiff affected the bank's equitable interest. It is true that by reason of the seizure the chattels were placed in the lawful custody of the bailiff. But the seizure did no more than removed the custody of the chattels from the borrower and transfer it to the bailiff. The bailiff took possession of the chattels subject to whatever charges, legal or equitable, affected them. Thus, if the chattels had been the subject of a valid legal mortgage, the chattels would have remained subject to the mortgagee's interest.

Where a judgment debtor is the owner of goods subject to the rights of other persons, the sheriff or bailiff may seize the goods if the debtor is entitled to possession for them, and may sell the debtor's rights in the goods, but not those of the other person entitled: Halsbury, supra, Vol.17 para.483. Thus, goods subject to an innkeeper's lien or to a lien for work done upon them can be seized, but the seizure is subject to the lien, and if the goods are sold by the sheriff or bailiff he is liable to the person entitled to the lien. See the authorities referred to in Halsbury, supra, at para.438, particularly Proctor v Nicholson (1835) 7C & P.67 and The James W. Elwell [1921] P.351. We think that goods subject to an equitable charge are in no different position from goods subject to a lien.

We think another analogy is to be found in insolvency law. When a receivership order is made, the order only affects the debtor's interest in property at the date of the order, so that a previous assignment of it by the debtor, whether legal or equitable, is effective against the receiver: see Halsbury, supra Vol.32 para.586 - 700 and Re Bristow [1906] 2 I.R.215. Similarly, in the absence of special statutory provisions, the making of a sequestration order will not affect the rights of third parties in the property vested in the Official Receiver or Trustee. A security interest such as an equitable charge over chattels in an interest in the chattels themselves and in distinguishable from a personal right to chattels. A right of the latter kind does not survive the debtor's bankruptcy, as does an interest in chattels. See Goode, supra at pp.50-51.

We do not think the legislation which authorizes the seizure of a judgment debtor's goods gives the bailiff a better title to the goods than that of the dispossessed owner. The warrant of distress referred to in s.53 of the Magistrates' Court Act merely authorizes the distrainment of goods and their sale. Neither the Act nor the warrant makes any reference to the extinguishment of the rights of third parties in the goods distrained.

Of course, if the bailiff had sold the chattels to a bona fide purchaser without notice of the bank's interest in them, the bank's rights would have been lost. But the intervention of the bank before the chattels were sold put prospective purchasers on notice of its interest. In these circumstances, although the bailiff could have sold the chattels the purchaser would have taken title to the chattels subject to the bank's interest in them.

Counsel for the respondent argues that as between the bank and the bailiff it was a case of competing equities, and that the equity of the bailiff in the goods should prevail.

We do not agree with this submission. It would be wrong to treat the bailiff as having an equity in the chattels. What the bailiff had was possession of the chattels pursuant to the statutory right to seize and sell them, and no more.

In the events which have happened since the goods were seized and having regard to the undertaking given by the bank, we think the appropriate orders to make are as follows:

1. Declare that the seizure by the bailiff of the chattels referred to in the Loan Agreement made between the appellant and the second respondent on 19 December 1989 did not affect the interest of the appellant in the said chattels.

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2. Otherwise, appeal dismissed.
3. Appellant to pay the first respondent's costs.