## PREFERENCES - RUNNING ACCOUNTS

### Questions and Answers

**Question - Philip Fox (Melbourne):**

Is the effect of the Halesowen case that you cannot take a security over an amount in the credit account kept by a company with a bank? If so, does it mean that a bank can never be protected against precedent actions by holding a charge?

**Response - Robert Baxt:**

I think the answer to the question is that in the analysis in the Charge Card case and the analysis of Roy Goode is that the bank cannot take a charge over the amount that is in credit because this is money that is in fact owed to the customer. That does not mean to say that the bank cannot take a charge over other assets of the particular company. I would put the question back to perhaps other members of the panel and to the members of the audience - what if the particular amount in question was converted to some other form of asset which could be charged in the context this no longer being a strict banker/customer relationship. Millett J says that the amount could be charged to a third party, but not to the bank which has a banker/customer relationship with the particular customer. I find it strange that the amount cannot be charged by way of equitable charge in that particular context. But if you do take a charge in that case and fail to register it under the equivalent of s.200 of the Companies Code then of course there are problems of having it avoided if liquidation occurs.

**Comment - SEK Hulme:**

The only thing I am wondering is whether you could charge it to a trustee for the bank. I do not suggest that the answer is necessarily yes, but one can see the possibility that it might be because you have managed to introduce a third person into the relationship. If so, then no doubt banks will have subsidiaries which can be used for this purpose.

**Question - John King (Auckland):**

Of course the topic is of interest to me, you might remember from last year. I wonder why the concern about the inability to take a charge because with the set-off situation you are of course in

a better position. Once you have your contractual set-off your right to take an accounting exercise, you are not involved with preferential creditors in that sort of thing. He simply has an amount which is due or not due and that is the end of it. If you have a credit to the bank of $100 and it is owed $50, at the end of the day there is only $50 left. So you are better off. Why worry about the charge? The set-off is a much better animal.

**Response - Robert Baxt:**

I think one of the things that remains unanswered despite Millett J's helpful judgment is the question of whether the amount that you say is in credit is in fact certain. If it is a contingent amount and there are some problems in relation to that, then query whether you can set that amount off or include that in the particular set-off. Millett J goes through a whole range of cases in which he discusses this issue and comes down very heavily in favour of the notion that the bank is in a pretty good position in that particular case. What Mr Justice King suggests in the Geraghty case is that, assuming that you do not have insolvency, you contract out of that situation; you enter into a separate arrangement between the bank and the customer. What Lord Justice Buckley said in the Halesowen case is that you did not really have a set-off at all, you had an accounting situation, so that the set-off question only related to whether you could oust the operation of the Bankruptcy Code or the equivalent. So you might be able to get around it in that situation. It is when liquidation occurs that some of these issues then become pretty important.

**Comment - Garry Tierney:**

I chip in as a person who has not the level of knowledge as the people beside me. There is another practical reason why a bank would, if they could, like to have the benefit of a charge as opposed to the mere right of set-off. The mere right of set-off is something which applies at a particular time and if the bank itself can take an equitable charge over the moneys owing to it by its customer it would prefer that position; it is quite common that it does happen - I have endeavoured to apply some ingenuity as to how you overcome the situation. If some third party, another bank for example or another financial institution or what you will, takes a charge over the totality of the assets of your customer and at the time when you may be wanting to exercise a set-off, not necessarily in a liquidation or bankruptcy situation, out of the blue could come a person with a charge which could defeat you if you have not in fact exercised your set-off or had a pre-existing properly drawn contractual right to set-off which takes effect before it. That presents some practical difficulties.

**Question - Rick Ladbury (Mallesons Stephen Jaques):**

I would just like to take up one point. I think the suggestion was made that there are difficulties in interposing a third party

in some of these transactions and I think that Bob Baxt referred to the problem that you might not have mutuality for the purposes of s.86. I think that that problem can be overcome and the way in which it has been addressed in, for example, some of the project financings is simply to require the sales proceeds accounts to be with a party who is not one of the lenders, so that the proceeds are paid into the bank account of a third party and then the lenders take a charge over that account. The lenders then rely upon their security and they do not have to rely upon any right of set-off under s.86.

**Comment - Richard Youard:**

If I had know that we were going to talk about Charge Card I would never have come. Or if I had finally come against my better judgment I would have brought with me a suitcase full of bits of paper because this is a subject on which people are extremely worked up in London. It is a sort of industry now and in my own office there is a small team who works, sometimes even full-time, trying to work out what the hell we do about this decision. We now have charge card bulletins circulating through the firm - none of which will solve the problem - they all produce ideas.

The background is the one that you have heard. Incidentally I will change that, I am addressing simply one question and that is whether the bank can take a charge on the deposit with itself. It is an old question, it is one we have faced for years. It is important in practice to banks but time and time again our banking customers come to us saying "Look, we want to grant further facilities or a new facility or something to a customer and they have got a deposit with us. Are we O.K.?" And we say "Well, sort of, a set-off will go so far", but for the sort of reasons you have heard mentioned it is not good enough. If you really want to be secure, take a charge. And they say "But does that work?" and we say, "Yes".

We also say, "Of course Roy Goode says something different". Now Roy Goode is a good friend of ours, we have worked with him on all kinds of things, but we recognise that humans being what they are, lots of people have idiosynchratic views on one or two items. Roy Goode has always been consistent on this subject really. He has always said that it does not work. We have examined his arguments time and again and we have found them wholly without merit; we told him so on lots of occasions and he is completely unabashed for reasons which are obscure.

Anyway, two or three years ago we were having a general review of the subject and we thought we would see if other people agreed with our views. We put together three silks who were practising in the field of banking law and we said "Look, let us just look at this one question - are we right or is Roy Goode right?" And they said, "Having thought about it, you are right". We said "It is rather important, are you sure?" and they said "Yes". So we

said "Do you have any doubts at all that Roy Goode is talking through his hat?" and they said "No". So we felt that it was a good basis for going on and so we went on and other city firms were doing the same and so god knows how many charges have been created in this manner. We felt wholly unabashed that Roy Goode disagreed with us because we could see absolutely no principle of law which was offended.

So what is our amazement when we pick up the "Times" one day and see a report of this case! At first we cannot take it seriously and then we make a few enquiries and we had to take it seriously because that is what the judges decided. We made a few more enquiries. I am told that it was not fully or properly argued on this point.

We were all somewhat astonished when Millett J says baldly the whole thing is conceptually impossible. I mean we do not find it conceptually impossible. One of my partners I may say froths at the mouth at this statement because citing Whitcomestone he says that if a judge can really describe a situation and say it is conceptually impossible he has denied his own argument. I am not sure how it works in a court of law, but in the end I think it comes down to a question of merger.

Roy Goode has one or two arguments which are ancillary. We find absolutely no problem in the concept that a bank can be at both ends of the same transaction. The deposit creates a debt which is a bit of property and we see no reason why that bit of property should not be charged to the bank.

The best analogy that I can think of, which the law already recognises without any problems at all, is in the property area where a landlord can grant a lease and that lease can be assigned back to the landlord. Now of course there is a doctrine of merger, but there is absolutely no problem in English law, I do not know if it is the same here, in keeping those two interests in property separate if you want to. So the landlord is in a sense the lessor and lessee, but if he wants to keep them separate he can.

I do not see why there is any problem at all in keeping the two separate in an analogous way in the case of this bank deposit, but the fact is that Millett J says that we cannot. Now I understand that there is not going to be an appeal, which is a bore. The Department of Trade has indicated that it would look very favourably on the possibility of legislating to reverse the decision, but in the meantime we are stuck with it. I mean it is not the sort of legislation which parliament is going to rush through ahead of all its other ludicrous activities, - so we are in a bit of a problem.

The most favoured solution on the whole, if you have a chance, is to use a third party, another wholly owned subsidiary. But the fact is that to put this to a client makes you indicate that the law is an ass.