SBSA v RAL 10 Aug 1990 16053005

Ref. to February 1989 SBSA purchase of $16,053,005.72 of bad debt of National Safety Council of Australia Victoria division NSCA from Rothschild Australia Ltd. RAL

NSCA bankruptcy March 1989 [NSCA had borrowed $400 million in 1986 that was bad debt in 1986]

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State Bank of South Australia v. Rothschild Australia Limited & Ors., Supreme Court of Victoria, 10 August 1990

Tadgell J.: This litigation was precipitated by the financial collapse in March 1989 of the National Safety Council of Australia Victorian Division (NSCA) which was ordered to be wound up by this Court on 24 April 1989, provisional liquidators having been appointed in March 1989.

On 17 February 1989 NSCA was indebted to the first-named defendant, Rothschild Australia Limited (RAL), for financial accommodation of $16,053,005.72 for various advances made in August and September 1988 under a finance facility granted in 1986, and accrued interest. NSCA, and in particular its chief executive officer, one John Friedrich, arranged during February 1989 to borrow from the plaintiff, State Bank of South Australia, sufficient to discharge the debt owed to RAL under the 1986 finance facility. The plaintiff accordingly paid the sum of $16,053,005.72 to RAL on 17 February 1989 on account of NSCA in discharge of the indebtedness of NSCA to RAL of that amount, and NSCA became correspondingly indebted to the plaintiff. The plaintiff's case is that it paid on the understanding that the money NSCA had borrowed under the 1986 finance facility provided by RAL had been used to acquire certain safety and rescue equipment of a kind used by NSCA in its operations, that RAL had security over that equipment for the debt and that the plaintiff would obtain the benefit of security over the same equipment. The plaintiff alleges that it was encouraged in that understanding by a representation made to it by RAL before the plaintiff paid RAL. In fact RAL had no security over equipment that the plaintiff understood had been charged in favour of RAL. A chattel mortgage taken by the plaintiff over what it understood to be equipment that had been charged in favour of RAL is (so the plaintiff alleges) worthless. Indeed it appears that the equipment that the plaintiff supposed was to provide its security may not exist. At all events the property does not seem to have been found by the liquidator of NSCA and the plaintiff alleges that, but for the judgment it now seeks, it would be unsecured, or substantially unsecured, as against NSCA for a huge debt.

RAL had security for the NSCA debt of $16,053,005.72 by way of deed of charge over what is described as NSCA's aircraft spare parts inventory. The plaintiff claims in the circumstances to be entitled to be subrogated to the benefit, as against the liquidator of NSCA, of such security as RAL had over the assets of NSCA and claims also, in effect, to be entitled to indemnity by RAL for its loss.

It is evident that the transaction between the plaintiff and RAL, completed on 17 February 1989 by the payment by the former to the latter, laboured under a regrettable and expensive misunderstanding between the two people who represented those parties in negotiating it. These were Mrs Jane Mary Cartmer, a senior corporate manager of the plaintiff, and Mr Louis Ayoub, then a senior non-executive in the lending department of RAL, and now an associate director. The misunderstanding seems to have been fostered by Friedrich, who was largely, if not wholly, responsible for bringing the plaintiff and RAL

together through Mrs Cartmer and Mr Ayoub. It is a great misfortune that, although each of Mrs Cartmer and Mr Ayoub acted throughout in complete and earnest good faith, the transaction went sadly awry for at least one of them and his or her employer. Each employee is, if I may say so, intelligent and educated and was generally favourably impressive as a witness. Yet they were not *ad idem* and that was calculated to produce great loss to either the plaintiff or RAL according to the result of this proceeding.

Each of the plaintiff and RAL had acted as a financier to NSCA for some time before February 1989. Having regard to the way in which the case was argued it is necessary to trace in some detail the circumstances in which, so far as the evidence discloses, each had done so.

RAL is a medium-sized merchant bank with an office in Sydney where Mr Ayoub is employed. NSCA had been one of its clients since about 1983 and had over the succeeding years obtained finance in relation to the acquisition by it in particular of aircraft and aircraft spare parts. There was a long-term finance lease by RAL to NSCA of two helicopters, one of which was sold in 1985 when part of the lease was paid out. The lease of the other helicopter continued until after the collapse of NSCA in 1989, when it defaulted in its lease payment and RAL repossessed the helicopter.

From November 1985 to January 1986 RAL made a number of short-term unsecured[928] advances to NSCA amounting to some $1.5 million to enable it to purchase helicopters. The evidence is that, during that period, those loans were ``virtually repaid''.

In February 1986, apparently with a view to formalising borrowing arrangements between RAL and NSCA, RAL offered a long-term ``come and go'' cash advance facility and the offer was accepted by NSCA on 20 February 1986. Pursuant to the facility NSCA could call on RAL to provide cash advances from time to time up to a total of $US1.5 million for the purpose of assisting NSCA with the purchase of aircraft, aircraft equipment, spare parts and accessories. Security was provided by way of a registered fixed charge over all of the so-called spare parts inventory of NSCA, including parts to be acquired. The amount of the facility was increased to $A3 million by the time the formal documents relating to it were prepared and executed in December 1986. An equitable charge over the spare parts inventory was executed on 10 February 1987. The value of the inventory was said to exceed $10 million in early 1987 and to have risen considerably above that by February 1989. Although the documents supporting the facility were not completed until February 1987, short-term advances were drawn down under it and some repayments were made from time to time during 1986. Remarkably, the balance owing at times during 1986 much exceeded the $3 million limit. For example, on 1 October 1986 the balance owing by NSCA was some $9.2 million but by 5 December 1986 the balance was nil. During 1987 (after the formal documents had been executed) the balance rose steadily until on 19 March 1987 it was some $19.9 million, fluctuating thereafter until by December 1987 it was again nil. The formal limit of the facility was increased to $5 million in June 1987 but nevertheless, by 8 December 1988, the debit balance was $14,960,000.

The draw-downs made by NSCA under the facility were described by Mr Ayoub's evidence as falling into two broad classes. The first class (group A) consisted of short-term borrowings to finance purchases of aircraft and related equipment where NSCA itself procured the long-term borrowing. The second class (group B) consisted of short-term borrowings to finance purchases of aircraft where RAL procured long-term borrowing for NSCA. In no case did RAL in its own right take a charge or other security over items purchased, except to the extent that the purchase was of spare parts for aircraft purchased, so to speak, together with the aircraft. When RAL undertook to procure long-term finance for the acquisition by

NSCA of an aircraft (i.e. in cases within group B) RAL initially paid the supplier and NSCA took title, becoming indebted to RAL. RAL then procured a long-term financier to repay the NSCA debt to RAL. This was achieved by RAL's purchasing the aircraft, as nominee of the long-term purchaser, and leasing it back to NSCA. The purchase price, consisting of loan funds from the long-term financier, was paid by the latter to RAL in discharge of the short-term debt that had been incurred by NSCA to RAL. As part of the sale and lease-back arrangement, NSCA provided to RAL (as nominee for the long-term financier) an invoice — drafted by RAL for NSCA — in which NSCA warranted that, upon payment of the purchase price, the title to the aircraft would become the absolute property of RAL (as nominee) ``free from all claims, encumbrances, liens or other adverse interests of any kind''. The invoice also directed RAL to make the cheque for the purchase price payable to RAL.

Transactions whereby RAL provided only short-term finance for NSCA (i.e. group A transactions) were much less formal and less documented than those in group B. In group A transactions funds were advanced by RAL upon assurances and evidence from NSCA that long-term finance would be procured by NSCA itself and used to repay the advances made by RAL.

At 2 August 1988 the balance owing by NSCA to RAL under the 1986 facility was only $8,375.63, the approved limit being $5 million. On 4 August 1988 NSCA drew down $2,500,000 under the facility as a group A transaction in which the long-term financier was said to be Partnership Pacific Limited, a subsidiary of Westpac Bank. NSCA drew down a further $2,500,000 under the facility on 23 August, again apparently a group A transaction, providing finance to 30 August 1988.

In about September 1988 Friedrich asked Mr Ayoub if RAL would make a further advance of $10 million, in addition to the total sum of $5 million that had been provided in the preceding month, to assist NSCA in the purchase of further aircraft or related[929] equipment. Authority was accordingly obtained on 22 September by RAL from its shareholders in London to provide NSCA with a temporary advance of up to $10 million as a short-term advance not to exceed 60 days. On 23 September 1988 NSCA drew down $9,960,000 from RAL, apparently repayable on 24 October 1988.

No part of the three advances amounting to $14,960,000 made by RAL to NSCA in August and September 1988 under the cash facility had been repaid by the end of December 1988. Mr Ayoub had during the last months of 1988 sought to obtain repayment but Friedrich, in circumstances not made very clear by Mr Ayoub in his evidence, fobbed him off. During that period the two were negotiating other transactions, including an arrangement for an operating lease of an aircraft that was to be acquired by NSCA for some $8 million. At the end of 1988 NSCA was indebted to RAL for the $9,960,000 that had been advanced under the facility in August and September, and interest, and was also liable to make periodical payments under nine long-term leases that RAL had arranged. According to Mr Ayoub's evidence Friedrich informed him from time to time during their many conversations towards the end of 1988 that he was negotiating for long-term finance with various lenders, including the plaintiff, to pay out the debt owed to RAL under the facility.

Default in repayment by NSCA under the facility with RAL dragged on into 1989. In late January 1989 Friedrich told Mr Ayoub that repayment would be made within a week, and then in early February Friedrich said it would occur in the week commencing 6 February. On 9 February Friedrich telephoned Mr Ayoub to say that repayment would be made in the following week, and that the ``take out'' finance was to be provided by the plaintiff on a lease. He gave Mr Ayoub Mrs Cartmer's telephone number and asked him to telephone her to confirm (or ascertain) the repayment date. Mr Ayoub swore that he

understood from this conversation that NSCA would be selling to the plaintiff the aircraft and equipment purchased by it and paid for by use of the advances made by RAL and would take a lease back from the plaintiff. He gathered that NSCA would issue its invoice to the plaintiff in much the same way as it had done in the long-term leasing transactions with RAL that I have described. Arrangements were made between Friedrich and Mr Ayoub during the conversation that the latter should calculate a pay-out figure on the footing that repayment would be made on 15 February and that he should notify Friedrich of the figure by fax. According to Mr Ayoub's evidence Friedrich asked him if he would include, in the letter he was to write advising the pay-out figure, a note confirming that RAL did not claim any interest in the equipment that the plaintiff was going to finance. Mr Ayoub swore that he asked Friedrich why he wanted such a note, saying that RAL had not provided one in the past and that surely NSCA would be issuing its usual invoice. Mr Ayoub's evidence was that Friedrich ``said Yes to the latter part of the question, but said he needed it anyway. He said he needed it for the SBSA'' (i.e. the plaintiff). Mr Ayoub's evidence continued:

``As I was pressed for time, I asked him whether it would be in order for me merely to confirm what was on the usual NSCA invoice. He said Yes and immediately after the telephone conversation I obtained a pay-out figure from the lending department, took a copy of a standard NSCA invoice and adapted it into the letter which Mr Friedrich had asked me to send.... At that time my understanding was that the NSCA had applied the advances made available to it by RAL in late 1988 to purchase aircraft and related equipment, that those advances were secured over aircraft spare parts and that those purchases were to be refinanced by the SBSA by means of leasing finance (requiring a sale by the NSCA of those assets to the SBSA and a lease back of them). In the light of this, it was my understanding that upon RAL being repaid its advances to the NSCA, the NSCA would pass title to the said assets to the SBSA (pursuant to the leasing transaction), and that the NSCA would provide to the SBSA a warranty as to clear title.''

On 9 February, Mr Ayoub sent a letter to Friedrich which, in part, read as follows:

``We understand that equipment purchased by the National Safety Council of Australia — Victorian Division and financed by Rothschild Australia Limited under a secured finance facility is to be refinanced by the State Bank of South Australia under a lease facility. We confirm that upon[930] repayment of all loans relating to the purchase of this equipment, title to this equipment will pass to the State Bank of South Australia free from all claims, encumberances [*sic*], liens or other adverse interest of any kind.

We understand that the Loan will be repaid no later than Wednesday 15 February 1989 and advise that the balance outstanding as at 15 February 1989 amounts to $16,039,275.31 comprising the following:

Principal	$14,960,000.00
Interest and charges	$ 1,079,275.31

Total	$16,039,275.31

Kindly arrange for $16,039,275.31 to be telegraphically transferred to our bank account on 15 February 1989 and for the State Bank of South Australia to advise us directly once the funds have been remitted. Please have this advice directed to either Lou Ayoub or Andrew McBeath.''

Also on 9 February 1989 Friedrich telephoned Mrs Cartmer, through whom he had had prior dealings with the plaintiff, and arranged with her to obtain finance from the plaintiff of about $16 million to pay out RAL in the next week.

I digress to explain as briefly as possible the dealings Mrs Cartmer and the plaintiff had had with Friedrich before February 1989. She began her employment with the plaintiff in about April 1988 and worked in its Melbourne office. Before that she had been employed successively by the Australian Bank Limited, the Bank of Singapore Limited and Midland International Australia Limited. She had learned of NSCA during her employment with the Australian Bank but had had little contact with it then. She came to know Friedrich in 1987 while she was employed by Midland, which had provided some finance to NSCA for the purchase of equipment, including aircraft, on the security of chattel mortgage. Believing NSCA to be a particularly good credit risk, Mrs Cartmer encouraged the plaintiff, after she had taken up employment with it (and apparently following a suggestion by Friedrich that he would like to refinance the facility that NSCA had with Midland), to offer a credit facility to NSCA. Mrs Cartmer prepared a submission for the plaintiff's lending committee in September 1988 which led ultimately to an offer by the plaintiff to NSCA of a lending facility of $21,250,000. Before that offer was accepted Friedrich told Mrs Cartmer that, in addition to seeking to replace the Midland facility, NSCA was considering purchasing some training aircraft for which it might require further finance. Friedrich sought that the plaintiff increase its offered facility limit to $31 million. Mrs Cartmer made a further submission to the plaintiff's lending committee accordingly, which was approved, and on 19 September 1988 the plaintiff made an offer to NSCA of a facility for $31 million, subject to the execution of a formal facility agreement. On 23 September NSCA accepted the offer and paid an establishment fee of $60,000.

A formal facility agreement between the plaintiff and NSCA was executed by NSCA before 16 November 1988 but it was not executed by the plaintiff until that date. In the meantime, in October 1988, Friedrich had requested an unsecured advance from the plaintiff of $10 million, said to be for use in the acquisition by NSCA of an aircraft. Mrs Cartmer was disposed to grant it but her superiors demurred to the provision of an unsecured loan and Friedrich's request was declined. Mrs Cartmer swore that Friedrich told her later — though she was unable to say how much later — that the transaction was ultimately financed by RAL.

On 2 November 1988 Friedrich telephoned Mrs Cartmer and told her that he wished to draw down under the facility for the purpose of the purchase of various pieces of new safety equipment. Mrs Cartmer swore that she inferred that the equipment, being new, could not be the equipment over which Midland held a chattel mortgage. On the same day Mrs Cartmer attended the NSCA office in St Kilda where Friedrich described the equipment to be purchased as high-powered turbine pumps and he showed her photographs and diagrams of the equipment in a catalogue. He said he would send her copies of the diagrams. On 14 November 1988 Friedrich sent to Mrs Cartmer by fax a copy of an invoice numbered 085 from J.H. Hodges Nominees Pty. Ltd. charging NSCA $8,394,510.50 for goods described simply as follows:

``12 turbine powered high[931]

volume pumping units

SN CA8-90086 to 97

@ $482,510.00 $5,790,120.00

5 breathing protection

containers SN DRA-11,

12, 13, 14, 15

@ $520,878.10 $2,604,390.50

$8,394,510.50

''

On 15 November, as Mrs Cartmer swore, Friedrich sent her copies of the diagrams and on 16 November she sent Friedrich copies of a mortgage debenture for execution by NSCA relating to the goods described in the invoice numbered 085. For some reason not clearly explained in the evidence the mortgage debenture was not to be executed by NSCA before the draw-down. Mrs Cartmer was content to receive a letter signed by Friedrich and sent by facsimile on 16 November stating that:

``In consideration of State Bank of South Australia (SBSA) permitting the drawdown of $8,394,510.50 on 16 November 1988, we hereby undertake to execute the amended Mortgage Debenture reference No. 6000Y/10/88 as soon as available.''

On receipt of the letter the sum of $8,394,510.50 was remitted by the plaintiff on 16 November to the account of NSCA with the State Bank of Victoria at Traralgon. It is to be noted that the money was advanced not only before any security document had been executed but in the absence of any check by Mrs Cartmer or anyone else on behalf of the plaintiff to ascertain whether the goods described in the invoice existed or, if they did, what their value was. Mrs Cartmer admitted that it was primarily her responsibility to see that such a check was made but she candidly conceded that she could not explain why one was not made.

There was a delay in the return by Friedrich to Mrs Cartmer of the executed mortgage debenture. When it was returned Mrs Cartmer noticed that the details of the equipment the subject of the charge had been altered in that the serial numbers of the items were not those set out in the invoice numbered 085. When Mrs Cartmer asked Friedrich for an explanation he told her (as she swore) that the equipment described in invoice numbered 085 was being financed by another party but was identical to the equipment described in another invoice which he had indicated by amendment of the mortgage debenture. Friedrich later sent Mrs Cartmer, at her request, a copy of the other invoice (numbered 087) and she was apparently content with that, following which the mortgage debenture was registered and

stamped, again without any check to see whether the goods existed. The evidence before me suggests strongly that they never did.

On about 13 December 1988 Friedrich requested of Mrs Cartmer a further draw down of $US1.3 million under the facility provided by the plaintiff to NSCA. It was said to be for the purchase of a second-hand Bell 212 helicopter. This finance was apparently provided by the plaintiff to the United States supplier after Mrs Cartmer received by facsimile a copy of a chattel mortgage executed by NSCA in respect of the aircraft. The original chattel mortgage was later received by Mrs Cartmer.

It is against the background I have sketched that one is to view Friedrich's request by telephone to Mrs Cartmer on 9 February 1989 for finance of approximately $16 million. Friedrich told Mrs Cartmer that he needed the funds within about a week and that the purpose of the draw-down was to repay bridging finance provided by RAL to NSCA. Mrs Cartmer swore that that was the first time she learned of any involvement of RAL with NSCA. Friedrich asked her to seek details from Mr Ayoub. She had not dealt with or met him but she knew RAL to have a high reputation as a merchant banker and assumed its integrity in any transaction to be beyond question. Friedrich proposed to Mrs Cartmer on 9 February that the transaction would be by way of sale and lease-back to NSCA for five years. She replied that the facility agreement contemplated an exposure of the plaintiff not exceeding three years, whereupon Friedrich told her that he would have to examine NSCA's cash flow. Mrs Cartmer swore that she could not recall specifically whether Friedrich told her that RAL had any security interest in the property that was to be given to the plaintiff as security — meaning, I take it, the property in respect of which it was then contemplated that the plaintiff was to be lessor to NSCA. That property was then unidentified by NSCA but Mrs Cartmer evidently assumed from what Friedrich had told her that it was identifiable and that RAL had a security interest in it.

After speaking to Friedrich on 9 February Mrs Cartmer — probably on 13 February —[932] telephoned to seek advice from Mr R.G. Laird, a member of Darvall McCutcheon, the plaintiff's solicitors. According to Mr Laird's evidence Mrs Cartmer explained to him that the plaintiff was proposing to advance some $15 million to NSCA in order to pay out RAL, which had a pre-existing security interest in equipment which had already been purchased. Mr Laird swore that Mrs Cartmer told him that the plaintiff was considering advancing funds under a leasing arrangement by which the plaintiff would become the lessor of equipment that was owned by NSCA or by some other party. Mr Laird advised that, in order to prepare the documents necessary for such a transaction, he would need to know (among other things) who owned the equipment and to have a description of it and its original value. Mr Laird also advised, as he swore, of the plaintiff's need — if it were to enter into a lease — to secure unencumbered title over the goods in question; and he told Mrs Cartmer that it would be prudent to secure from an appropriate officer of NSCA a statutory declaration that would satisfy the plaintiff that, once the RAL interest was eliminated, the plaintiff could gain, without anything more, clear title to the equipment. According to Mr Laird Mrs Cartmer did not tell him how she came to believe that RAL had a pre-existing security interest in the equipment or what sort of security interest it was. She suggested, as he swore, that she obtain a letter from RAL with a view, in effect, to negating any previous security held by RAL.

After speaking to Mr Laird on 13 February Mrs Cartmer sent a facsimile letter to Friedrich on that day asking him to provide the information Mr Laird wanted. On the same day, or the day after, Friedrich telephoned Mrs Cartmer and told her that NSCA owned the equipment and that it would provide serial numbers and invoices. Friedrich also told Mrs Cartmer on or about 14 February that, having examined

the prospective cash flow of NSCA, he wished the security that the plaintiff was to receive to be a chattel mortgage and not a lease. Mrs Cartmer conveyed that information to Mr Laird, probably on 15 February.

On Monday 13 February Mr Ayoub, as he swore, telephoned Mrs Cartmer, as Friedrich had asked him to do. He did not know her but introduced himself and in effect summarised what Friedrich had told him on 9 February about the prospect of RAL's being paid out early that week. Mr Ayoub swore that he asked Mrs Cartmer to confirm the precise date when payment could be expected. According to Mr Ayoub Mrs Cartmer told him that payment would probably not be made until the Monday of the following week (20 February) and he asked to be given at least two days' notice of the repayment. According to Mr Ayoub's evidence no mention was made in the telephone conversation with Mrs Cartmer of any security that RAL then had or that the plaintiff was hoping to obtain, of the nature of the finance that the plaintiff was proposing to provide, of any need for RAL to provide any kind of assurance to the plaintiff about title to goods or of the nature of the goods that RAL had financed or that the plaintiff was proposing to finance. Mrs Cartmer did not controvert any of Mr Ayoub's evidence about that telephone conversation and I see no reason not to accept it. Indeed it seems that Mrs Cartmer has no recollection of the conversation but she does not deny that it occurred. I do not doubt that it did.

According to Mr Ayoub's evidence he had two relevant telephone conversations on 15 February. There was one with Friedrich, who told him that the RAL advance would be repaid on 17 February, and one with Mrs Cartmer in which she also told him that RAL could expect payment on 17 February. Mrs Cartmer's evidence confirmed that Mr Ayoub had spoken to her on 15 February. Although her evidence of the conversation was not exactly parallel to Mr Ayoub's, she did swear in effect that she told Mr Ayoub that she expected the plaintiff to be in a position to pay RAL by 17 February. Significantly, Mr Ayoub swore in effect that there was no mention between himself and Mrs Cartmer on or before 15 February of the provision by RAL to the plaintiff of any assurance of clear title. Equally significantly, Mrs Cartmer gave no evidence that she had asked Mr Ayoub for any such assurance. Furthermore it is common ground between Mr Ayoub and Mrs Cartmer that she at no relevant time told him that, as Friedrich had informed her by 14 February, Friedrich wished the transaction between the plaintiff and NSCA to be by way of a chattel mortgage and not a lease.

Having spoken to Mrs Cartmer on 15 February Mr Ayoub sent her on that date, first[933] by facsimile and then by post, a letter that has become central to this case. The relevant parts of the letter read as follows:

``We refer to our telephone conversation this morning.

We understand that equipment purchased by the National Safety Council of Australia — Victorian Division and financed by Rothschild Australia Limited under a secured finance facility is to be refinanced by the State Bank of South Australia under a lease facility. We confirm that upon repayment of all loans relating to the purchase of this equipment, title to this equipment will pass to the State Bank of South Australia free from all claims, encumberances [*sic*], liens or other adverse interest of any kind.

We have been advised that the State Bank of South Australia will be advancing the necessary funds on Friday 17 February 1989 and that you have instructions to remit the funds directly to Rothschild Australia Limited.

Kindly arrange for the amount of $16,053,005.72 to be telegraphically transferred to our bank account on 17 February 1989. The details of our bank account are as follows...''

Mr Ayoub swore that he drafted the letter by taking the letter he had written to Friedrich on 9 February and altering it. Mr Ayoub said in his evidence:

``I remembered what Mr Friedrich had told me about the SBSA wanting confirmation that RAL claimed no interest in the goods that the SBSA was financing, so I included the first paragraph [meaning the first substantive paragraph of some 10 lines] although I had not been asked by Jane Cartmer to do so.''

Plainly, Mr Ayoub, when he wrote the letter of 15 February, understood that there was to be a lease from the plaintiff to NSCA and he swore that he then still understood the position to be as he had discussed it with Friedrich on 9 February.

Upon receipt by facsimile of Mr Ayoub's letter of 15 February Mrs Cartmer on the same day sent the text of it by facsimile to Mr Laird and shortly afterwards — probably also on 15 February — discussed it with him in a telephone conversation. It is a most curious feature of the case that, although Mr Laird swore that Mrs Cartmer told him that she would obtain a letter from RAL stating (in effect) that the goods over which the plaintiff was to obtain security were unencumbered, Mrs Cartmer herself gave no evidence that she had suggested to Mr Laird that she should seek such a letter and she gave no evidence that she asked Mr Ayoub for one; and Mr Ayoub swore that the matter was not discussed between him and Mrs Cartmer before he wrote the letter of 15 February. That Mrs Cartmer did at some stage discuss such a letter with Mr Laird is borne out by an undated file note recording a telephone conversation he had with her which reads, in part, ``Chattel mortgage... unencumbered letter Rothschild... stat. dec. by John Friedrich chief executive...''. With (as I should judge) some uncertainty Mr Laird swore ultimately that that note referred to a telephone conversation of 15 February. If the conversation did occur on 15 February it is unclear from the evidence whether it occurred before or after Mrs Cartmer received the letter from Mr Ayoub on that date. I think the correct conclusion upon the evidence is that Mr Laird did not ask Mrs Cartmer to obtain such a letter and that she did not ask Mr Ayoub for it; and (contrary to Mr Laird's evidence) that Mrs Cartmer did not suggest to Mr Laird that she obtain it. It is as likely that it was discussed between Mrs Cartmer and Mr Laird after she had received it as before she received it. At all events it was unquestionably discussed between them in the context of the plaintiff's being satisfied, before paying money to RAL, that RAL claimed no interest in the property over which the plaintiff intended to take security. That property was, of course, still unidentified. The idea that RAL should provide an assurance by letter that it claimed no interest in equipment that was to be (as it was said) ``refinanced'' by the plaintiff no doubt came from Friedrich, who proposed it to Mr Ayoub and probably mentioned it to Mrs Cartmer, although Mr Ayoub and Mrs Cartmer may not themselves have discussed it. The letter would therefore have come as no surprise to Mrs Cartmer and she naturally passed it on to Mr Laird for his consideration.

Mrs Cartmer has sworn that she understood the following from the letter: that RAL had[934] advanced funds to NSCA to purchase equipment and that RAL had taken security over all of that equipment; that the whole of the indebtedness of NSCA to RAL referred to in the letter arose out of the purchase of the equipment referred to in the letter; that upon payment by the plaintiff to RAL of the funds ``as outlined in the letter'', RAL would release its security over that equipment and the equipment would thereby become unencumbered; and that the equipment in question was the same equipment which the funds had originally been used to purchase. Mrs Cartmer swore that, in her mind, the fact that the letter had

been copied to Friedrich meant that all three parties — the plaintiff, RAL and NSCA — were talking about the same equipment. It is important to appreciate that the equipment that was intended to provide the plaintiff's security was still unidentified to or by any of Mrs Cartmer, Mr Laird and Mr Ayoub. Mrs Cartmer referred in her evidence to the fact that Mr Ayoub referred to equipment being refinanced under a lease facility by the plaintiff. She swore, however, that, although Friedrich no longer wanted a lease and wanted the security to be a chattel mortgage, the plaintiff still needed RAL to release its security in the equipment (unidentified) and that it was irrelevant to her that Mr Ayoub conceived that the method of refinancing would be by lease. For his part Mr Laird gathered from Mr Ayoub's letter of 15 February that the RAL facility was described as ``a secured finance facility'' and that:

``upon repayment of all loans relating to the purchase of this equipment, title to this equipment will pass to the State Bank of South Australia free from all claims, encumbrances, liens or other adverse interest of any kind.''

Mr Laird had been told by Mrs Cartmer, as Mr Ayoub had not, of Friedrich's proposal that NSCA should be a chattel mortgagor to the plaintiff rather than a lessee from it. Mr Laird was nevertheless concerned that the plaintiff should be satisfied, as he said, that the interest of RAL had been eliminated and that there were no other interests which would take priority to the plaintiff's unencumbered title.

Mr Laird regarded the letter from Mr Ayoub dated 15 February as providing a sufficient safeguard to the plaintiff that, upon its making payment to RAL, the plaintiff would receive security from NSCA ahead of any encumbrance in favour of RAL. His evidence was that he told Mrs Cartmer that the pre-existing security interest in favour of RAL ``if it in fact existed, needed to be dealt with''. Mr Laird swore that Mrs Cartmer had led him to believe that RAL had a security interest. It is plain, however, that he did not know what Mrs Cartmer supposed that interest to be; and Mrs Cartmer could not say in her evidence how she supposed that such an interest had come about. Mr Laird took Mr Ayoub's letter to render unnecessary an investigation of any interest of RAL in the property over which the plaintiff proposed to take security. More particularly, he did not take, or advise Mrs Cartmer to take, any step to ascertain whether any security which RAL had would be subordinated to any security the plaintiff might obtain. He did not do so because (for one reason) he did not know, and did not seek to ascertain, what property was or was to be the subject of the plaintiff's security transaction. Mrs Cartmer, too, was quite unaware, at any time at which she was speaking to Mr Laird about the matter, what property it was over which she supposed (and led Mr Laird to suppose) RAL had a security interest and over which the plaintiff was to take a security interest. The failure on the part of Mr Laird and Mrs Cartmer to concentrate on that matter cannot be over-emphasised as one that is critical to the determination of this proceeding.

Mr Laird and Mrs Cartmer assumed that Mr Ayoub's letter constituted a sufficient release of any security RAL might have asserted over the property in which the three of them expected the plaintiff was to become interested. Mr Laird decided, and he advised Mrs Cartmer, that no search should be made to ascertain what security interest, if any, RAL had over property of NSCA. He reasoned that Mr Ayoub's letter was sufficient to preclude RAL from asserting, as he swore, ``a security interest in the goods in priority to the State Bank'' (*scil.* the plaintiff). On 16 February Mr Laird wrote to Mrs Cartmer to say:

``You will appreciate that I have not conducted further corporate searches in respect of the Council and take it that in the circumstances under consideration the searches will not be necessary.''

He sent Mrs Cartmer with the letter a draft chattel mortgage, making provision for insertion in the Fifth Schedule thereof a[935] description of the chattels over which security was to be taken by the plaintiff, for he was at no stage told, nor did he seek to discover, what they were to be. Mr Laird also sent a notice of particulars of charge (Form 47) so that registration could be effected. The letter said:

``The Form 47 is also enclosed together with an Annexure Sheet in case the list of equipment is lengthy. Obviously, the description of the equipment in the Form 47 should be identical with the description of equipment in the Fifth Schedule.''

Mr Laird also enclosed a form of statutory declaration for making by Friedrich.

The *Companies Regulations* provide for a form of registrable memorandum of release (known as Form 52) by a chargee. Mr Laird conceded in cross-examination by counsel for RAL that it is common practice for a prudent solicitor, when lodging for registration a chattel mortgage in respect of property over which there has been a prior security, to lodge with it a Form 52 if the prior chargee has executed one. Mr Laird further conceded that it would have been more prudent to have advised Mrs Cartmer that a Form 52 release be obtained from RAL in preference to a mere unregistrable letter. In fact Mr Laird did not discuss with Mrs Cartmer the question of the plaintiff's obtaining a Form 52 release from RAL, or turn his mind to it. Mr Laird was unable to explain in cross-examination why he did not do so, save to say:

``I think the question of the security aspects were addressed by the letter provided by Rothschilds. Rothschilds would be hard-put to assert security over the items in question, given the terms of the letter provided.''

It is again to be carefully noted that Mr Laird never knew at any relevant time what the ``items in question'' were, and Mrs Cartmer did not know either until an equipment schedule was provided by Friedrich shortly before the plaintiff paid over the money to RAL on 17 February. It goes without saying that Mr Ayoub was always ignorant of the description of the property that was intended to provide the plaintiff's chattel mortgage security. Indeed, so far as he was aware, the transaction between NSCA and the plaintiff was to be by way of lease.

As well as seeking no form of registrable release from RAL the plaintiff made no search to ascertain what security, if any, RAL had and, if there was one, over what property it lay. Mrs Cartmer and Mr Laird decided deliberately that no search should be undertaken although, as the evidence made plain, it would have been perfectly possible to have made one in the time available. Instead, both were content to trust Mr Ayoub's letter of 15 February and a statutory declaration from Friedrich to provide all the safeguards they needed.

On 16 February Mrs Cartmer sent to Friedrich by facsimile for his consideration and, if he approved, execution, the draft chattel mortgage that had been prepared by Mr Laird; and on 17 February she sent Friedrich a proposed form of statutory declaration and the incomplete Form 47. The form of statutory declaration was as follows:

``from enquiries I have made I am satisfied that the assets property and equipment charged under the mortgage debenture [the mortgage debenture being described in the heading to the document] are the property of the mortgagor and that they are free from all mortgages charges and other encumbrances whatsoever...''

Also on the morning of 17 February Friedrich's secretary, Mrs Pollard, sent to Mrs Cartmer by facsimile a draft equipment schedule designed to be part of the Form 47. This was the first and only idea Mrs Cartmer obtained of the nature or identity of the property over which NSCA proposed that the plaintiff should take security. The equipment schedule described as follows (in what might be thought a not very revealing fashion) the equipment over which the chattel mortgage was to provide security:

``(1) Emergency[936]

Equipment Containers

Type FIN 78 pumping

units x 24 @

$454,285.71 Serial No.

HN 877 to HN 0900 incl. $10,902,857.04

(2) Emergency

Equipment Containers

Type FIN 83 generating

units x 12 @

$420,310.00 Serial No.

HN 101/G/15 to

HN 101/G/24 incl. $5,043,720.00

(3) Communication Units

x 2 Type FIN 79 @

317,620.00 Serial No.

MD 003 to MD 004 $635,240.00

(4) Emergency

Equipment Container

Resource Equip-

ment Hydraulic/

Pneumatic x 2 units

Type FIN 80 @

294,111.00 Serial No.

HN 102/HP/02 to

HN 102/HP/03 incl. $588,222.00

Total invoice value $17,170,039.04

''

Mrs Cartmer approved the equipment schedule, apparently in a telephone conversation with Mrs Pollard, shortly after receiving it on 17 February, and was told by her that invoices would be provided later in the day. In the early afternoon of 17 February Mrs Cartmer received by facsimile from Mrs Pollard a letter forwarding ``executed'' facsimile copies of the statutory declaration and of the Form 47 (with the equipment schedule annexed) and of the last page, containing the execution clause, of the chattel mortgage. The letter said ``We undertake to sign original of such documents and return them to you within 24 hours of receipt of same''.

On the strength of these facsimile copy documents Mrs Cartmer authorised the plaintiff's head office in Adelaide to release $16,053,005.72 to the bank account of RAL in Sydney, and the funds were duly transmitted to that account by telegraphic transfer during the afternoon of 17 February. It is to be distinctly understood that, at the time she authorised the release of the money to RAL, Mrs Cartmer had not received any invoices relating to the items purportedly described in the equipment schedule and she had no other verification of the existence of any of the items. She had simply assumed that the items set out in the equipment schedule were items over which RAL had security and that RAL was relinquishing that security in favour of the plaintiff. There is no evidence to explain why Mrs Cartmer authorised the release of the money to RAL without sighting invoices or other evidence designed to authenticate the equipment schedule.

According to Mr Ayoub he had two telephone conversations with Mrs Cartmer on 17 February. The first was, as he swore, at about 10.00 a.m., when he telephoned her. They discussed a possible settlement on that day. The discussion was inconclusive, because she had not by then received from NSCA the documents she required, and they arranged to speak again that afternoon. Mrs Cartmer did not suggest that that conversation did not occur and I conclude that it probably did, noting, however, that she said nothing about it in her evidence-in-chief. The second conversation was said by Mr Ayoub to have occurred at about 12.30 p.m. when Mrs Cartmer telephoned him and said that she had sent the funds to RAL. Mrs Cartmer was content to concede in cross-examination that this conversation probably occurred, although again she did not mention it in her evidence-in-chief. According to Mr Ayoub Mrs Cartmer asked him in that conversation to send a note acknowledging that RAL had received the funds and that RAL did not have any interest in the equipment the plaintiff was financing. Mrs Cartmer accepted in cross-examination that she probably did ask for acknowledgement of receipt but denied that she made the second request. Mr Ayoub swore that he was surprised to have had the second request and that, when it was made, he referred Mrs Cartmer to his letter of 15 February. According to him she replied that she had not seen it, whereupon he said that he would send her another copy if necessary, but that it would be along the same lines as the one he had already sent. According to him, she sounded as though she shuffled some papers and ultimately said she had the letter and did not pursue the second

request, but said that she still needed a note confirming receipt of the funds. Mrs Cartmer denied in cross-examination that the conversation contained an ingredient relating to RAL's interest. This discrepancy between the evidence of Mr Ayoub and that of Mrs Cartmer suggests that one of them is either confused or mistaken. I cannot conclude that Mrs Cartmer did not receive and read (albeit, perhaps, cursorily) the letter of 15 February, for the evidence is plain that she sent the text of it on to Mr Laird. On the other hand, I find it difficult to suppose that Mr Ayoub merely imagined that the conversation contained the second of the ingredients as to which he deposed, and I think he was being truthful in swearing that it did. Mrs Cartmer,[937] having omitted to mention the conversation in her evidence-in-chief, may be supposed to have regarded it as unimportant, and she may on that account have an imperfect or selective recollection of it. Having closely considered the discrepancy, I have come to the conclusion that Mr Ayoub's version of the conversation is probably accurate, as well as truthful, and that it is to be preferred. That conclusion at least causes one to question whether Mrs Cartmer actually placed any or any substantial reliance on the letter of 15 February, before she arranged for payment to be made to RAL, in relation to the matter of RAL's interest in the equipment over which the plaintiff was expecting to take security. Having regard, however, to the result at which I have arrived on other grounds, I need not investigate the consequences of the discrepancy in any further detail. I do not base any conclusion upon it.

On 20 February and in March 1989 Mrs Cartmer sought invoices from NSCA relating to the goods described in the equipment schedule but did not receive them.

After the collapse of NSCA had become publicly known in March 1989, and provisional liquidators had been appointed, Mrs Cartmer telephoned Mr Ayoub on about 23 March and sought from him a copy of a release and a schedule relating to the items RAL had financed and which she believed the plaintiff had refinanced on 17 February. It seems strange that she sought a release at this stage, having apparently regarded one as unnecessary before she authorised payment of the money to RAL. Mrs Cartmer also asked Mr Ayoub if he had invoices for the equipment and whether he had ever sighted it. He replied that he had never sighted the equipment and had never had invoices or any specific details of it, and that RAL's security had been over aircraft spare parts by way of registered charge but that otherwise the loans made by RAL had been unsecured.

The plaintiff's case against RAL as pleaded alleged that it suffered loss as a result of various defaults of RAL. Ultimately, however, all causes of action against RAL were abandoned save one. It is that, in the letter of 15 February 1989, RAL made in trade or commerce representations and statements amounting to an engagement in conduct that was misleading or deceptive or was likely to mislead or deceive contrary to sec. 52 of the *Trade Practices Act 1974.* The plaintiff seeks compensation for loss it alleges it suffered as a result of reliance on and having been induced by the alleged representations and statements.

The representations and statements alleged by the plaintiff against RAL were (in the end) elaborately pleaded in para. 9 of the further amended statement of claim. I need not set out the whole of para. 9. The gist of it, so far as it was argued, is that, by its letter of 15 February RAL represented to the plaintiff:

- — that the money lent by RAL to NSCA had been applied by NSCA to purchase equipment;
- — that RAL held security over *that* equipment (which necessarily existed);

- — that, upon paying RAL sufficient to discharge the debt for money lent by RAL to NSCA, the plaintiff would (or could) obtain in substitution for RAL, security over the same property as that over which RAL had had security.

The letter of 15 February was capable of conveying the first of these representations. Assuming that it did, and that Mrs Cartmer was induced by it to act, it was true. In my opinion, however, the letter was not reasonably capable in the circumstances of conveying the second or the third of the alleged representations and, even if it was, I am not satisfied that Mrs Cartmer was induced by either of them to act as she did in causing the plaintiff to advance the money to NSCA.

The question whether there was any and if so what representation is logically distinct from the question whether, if there was, there was an inducement by it. In fact there is, however, some overlapping here, as there must often be in similar cases: what the letter represented to Mrs Cartmer is to be assessed in the light of what she knew apart from the letter; and she is to be taken to have acted as a result of the combination of her knowledge.

The assumption by Mrs Cartmer that RAL had security over the same goods as those she understood were to provide security for the plaintiff does not square readily with the statutory declaration that she had sought from Friedrich and obtained from him on 17 February, which stated that the property to be charged under the mortgage debenture was ``free from all mortgages charges and other[938] encumbrances whatsoever...''. That, however, is perhaps only a straw in the wind, for Mrs Cartmer said in cross-examination that she assumed the statutory declaration to refer to encumbrances subsequent to any in favour of RAL. A critical question is whether Mrs Cartmer was reasonably entitled to understand Mr Ayoub's letter of 15 February to convey to her that, if the plaintiff were to advance money to discharge the debt owed to RAL, the security for that debt would be discharged and the property affording the security would be available as security for the plaintiff. In truth I think the ultimate question is probably rather narrower: whether Mr Ayoub's letter reasonably represented to Mrs Cartmer the fact that RAL had security over the property that was or was to be set out in the equipment schedule provided to her by NSCA. In my opinion the answer to both questions must be no.

Mrs Cartmer had no idea at all of the form of the security held by RAL. She never sought to find out and could not have ascertained it from the letter. Nor did she know or seek to discover what property furnished RAL's security, and she could not have ascertained that from the letter. Moreover, Mrs Cartmer did not know until the morning of 17 February what property NSCA was offering as security to the plaintiff. When she received what purported to be a description of it she unfortunately took no steps to seek to match it with any equipment over which RAL might have had security; or indeed to ascertain where it was or to identify it otherwise than by reference to the cryptic descriptions given in the draft equipment schedule that had been prepared by NSCA for the chattel mortgage. Mrs Cartmer expected that NSCA would provide invoices from the suppliers of the equipment but did not sight them or seek to sight them before arranging for the plaintiff to pay over the money on 17 February. She assumed that NSCA owned the equipment described in the equipment schedule because Friedrich had told her so, and must therefore have assumed that it was not on lease to NSCA from RAL. Neither Mrs Cartmer (nor Mr Laird) could reasonably have gathered from Mr Ayoub's letter that title, in the sense of ownership, would pass from RAL to the plaintiff. They would of course have been entitled to reason from the letter that RAL had security other than as lessor — e.g. as mortgagee or chargee — but over what property? For all that the letter told them, RAL might have had (as in fact it did have) security for its debt over property of

NSCA other than that which had been acquired by NSCA with the money advanced by RAL, and other than that which was to provide security for the plaintiff. Mrs Cartmer also did not know or care (as she acknowledged in cross-examination) whether NSCA was indebted to RAL for a sum in excess of approximately $16 million that the plaintiff's advance was to discharge, and for which excess the security might be retained by RAL. The fact that Mrs Cartmer was not concerned to match up the property constituting the security that the plaintiff was to take with the property constituting the security that RAL had was central to the plaintiff's embarrassment. Her chief reason now advanced for not doing so, it seems, is that she claims to have understood from Mr Ayoub's letter that RAL had advanced funds to NSCA to purchase equipment and that RAL had taken security over all of that equipment; and that the whole of the indebtedness of NSCA to RAL referred to in that letter arose out of the purchase of the equipment referred to in the letter. Again one must ask: what equipment? The letter was reasonably calculated to convey to Mrs Cartmer the fact that the money lent by RAL had been applied by NSCA in the purchase of equipment. The letter did not, however, identify any equipment and in my opinion it did not reasonably convey any idea of what equipment NSCA had purchased with money provided by RAL or that RAL knew what it was or where it was. Nor, in my opinion, did the letter reasonably convey to Mrs Cartmer the fact that the security given by NSCA to RAL for money lent by RAL was over equipment purchased with that money.

It is an important part of the plaintiff's case that, by his letter, Mr Ayoub represented to the plaintiff that the equipment over which the plaintiff intended to take security did in fact exist. The criticism now sought to be made of RAL is that, acting on that representation, the plaintiff paid out money in the expectation that it would receive security over property that did exist, whereas the property described in its instrument of security did not, or probably did not, exist. In my view that contention can be made good only if Mr Ayoub's letter can[939] reasonably be read as meaning that equipment of NSCA purchased with RAL funds was equipment over which RAL had taken security. As I have said I do not regard the letter as capable of bearing that meaning.

Mrs Cartmer swore that she regarded the letter of 15 February as constituting a release by RAL of any claim by RAL over identifiable property, so that no other release from RAL need be sought — as for example by a Form 52. Again one must ask: over what property should it be regarded as constituting a release? The plaintiff would say that it constituted a release in respect of any property that was purchased by the amount of about $16 million advanced to NSCA. RAL would not disagree, for there is no doubt that RAL has been fully paid out and now claims no security for advances made under the cash advance facility. Taken to its logical result the plaintiff's contention amounts to saying that, by the letter of 15 February, RAL represented that it had security over, and agreed to release from security in favour of the plaintiff, any property that NSCA claimed was purchased with the sum of approximately $16 million.

The regrettable fact was that the plaintiff left it entirely to NSCA to specify what was to be the property over which the plaintiff was to have security. The plaintiff, through Mrs Cartmer, intended to accept and take (or purported to take) security over the property that NSCA designated, and no other. The NSCA could have designated any kind of property at all that it thought fit (and it seems that it probably did so) for the plaintiff to accept it as security. One always comes back to the question: what equipment was Mr Ayoub referring to in his letter of 15 February? The answer must be that he was referring to no specific or identifiable equipment over which RAL claimed security. So far as it gave a release, the letter cannot in

my opinion be construed as indicating more than that, upon the payment to RAL of all loans that were used by NSCA to purchase equipment, RAL would claim no interest in that equipment.

Put in another way, it might be said that the letter was to be understood as representing that NSCA had in fact purchased equipment with the money provided by RAL and that all and any equipment (without identifying it) purchased by NSCA with the funds provided by RAL could be treated by the plaintiff, after the funds advanced by RAL had been repaid, as unencumbered to RAL. To that extent the representation was true. If the letter were to be so understood it could not, I think, be properly understood as carrying the further representation that RAL did claim security over all and any unidentified equipment that NSCA might have bought (or claimed that it had bought) with the money it advanced and, by implication, a representation that unidentified equipment did exist.

No doubt the problem created for the plaintiff arose from, or was much contributed to by, the curiously unconventional manner in which the large, important and complex transaction was settled. Here was a case in which NSCA, as debtor in sale, made arrangements with the plaintiff through Mrs Cartmer in Melbourne to obtain a transfer of funds from the plaintiff's head office in Adelaide to pay out RAL as creditor in Sydney. The common supposition was that the associated securities would be appropriately dealt with but in truth it must be said that there was seriously inadequate investigation by the plaintiff to ascertain even what the securities were. The normal procedure upon settlement of a transaction of the kind would have resulted in its taking place around a table by way of exchange of a series of interrelated instruments carefully scrutinised by legal advisers: the plaintiff would normally have insisted on being handed a release from RAL of its security and being handed an executed and authenticated security from NSCA before handing over to RAL a sum in excess of $16 million. Mrs Cartmer referred to the ``dislocation'' of the interested parties. This, together with some pressure exerted and a sense of urgency generated by Friedrich, was, as I gathered, said to be a justification for the use of modern electronics, so that no party had the opportunity or the advantage of setting eyes on any of the others; and there was no supervision of the settlement by any legal advisers. I am obliged to find on the evidence that the inducement for the plaintiff's acting in that way was not Mr Ayoub's letter. Mrs Cartmer was enthusiastic in her initial endeavour to cause the plaintiff to provide a financial facility to NSCA and she was always of the opinion that the NSCA was an irrefragable risk. She was told by Friedrich that the purpose of the proposed draw-down of about $16 million under the facility was to[940] repay bridging finance provided by RAL; and I conclude that it was Friedrich who led her to believe that RAL had a security interest in the property purchased with the RAL advance. Mr Laird's evidence makes this relatively clear, for Mrs Cartmer suggested it to Mr Laird before she had received Mr Ayoub's letter of 15 February. She gave evidence, in effect, that her opinion of NSCA as a credit risk was such that the obtaining of security from it was little more than a formality. This and other evidence (for example, her acceptance of Friedrich's assertion as to NSCA ownership of property and her dealing with the transaction for $8,394,510.50 on 16 November 1988) suggests that Friedrich had Mrs Cartmer very much in his confidence. She was, as I would conclude, most willing — if not anxious — to fulfil his request for an urgent provision of funds on 17 February 1989. So far as I can find the evidence does not disclose any cause for urgency or haste save that Friedrich declared it.

In my opinion the evidence does not afford a satisfactory basis for a conclusion that RAL made a representation contrary to sec. 52 of the *Trade Practices Act.* The plaintiff's claim against RAL should accordingly fail.

The plaintiff's claim to be subrogated to the rights of RAL as a secured creditor is put in this way. On any view it was the intention of all parties — the plaintiff, RAL and NSCA — that the plaintiff on behalf of NSCA should pay out the indebtedness of NSCA to RAL, a secured creditor. It was also the intention — or at least the expectation — of the plaintiff and RAL, and NSCA represented to them both, that the plaintiff would, upon making payment to RAL, become a secured creditor of NSCA for the amount advanced by the plaintiff and interest accruing thereon. In fact, the security that NSCA purported to grant to the plaintiff and that the plaintiff purported to take (if indeed the plaintiff obtained any security at all) was probably worthless. So much seems to be substantially common ground, if not precisely proved. It was assumed in the course of argument that the plaintiff's failure to obtain a security, or a proper security, for its advance was largely, if not wholly, attributable to the conduct — possibly fraudulent — of NSCA, acting through its chief executive officer, John Friedrich. Fraud, however, was not pleaded and it is inappropriate to make any specific finding about it. It may at least be said that NSCA led the plaintiff to believe that it would obtain a good security and that it did not do so. In the circumstances the plaintiff contends that equity entitles it to stand in the shoes of RAL and to enforce against the liquidator of NSCA the security that RAL had for the debt that the plaintiff's payment discharged. In my opinion the contention is sound.

There is ample authority for the proposition that, in certain circumstances, when a debtor borrows money to pay off a secured debt, the lender may be subrogated to the security of the creditor whose debt is paid off. The circumstances that will attract a doctrine of subrogation of that kind have not always been uniformly expressed and the question now arising is whether the circumstances of the present case do attract such a doctrine.

In *Ghana Commercial Bank* v. *Chandiram* (1960) A.C. 732 at p. 745, it was said by Lord *Jenkins* for the Judicial Committee that:

``It is not open to doubt that where a third party pays off a mortgage he is presumed, unless the contrary appears, to intend that the mortgage shall be kept alive for his own benefit: see *Butler* v. *Rice* [1910] 2 Ch. 277, 282, 283.''

There are suggestions in later authorities that that dictum, widely expressed as it is, cannot be taken altogether literally, and that it must be read in its context. It can scarcely be thought to avail a third party who pays off a mortgage officiously, or *in invitum* without arrangement with the mortgagor or the mortgagee.

Another explanation of the doctrine of subrogation, also in some respects widely expressed, is that of *Walton* J. in *Burston Finance Ltd.* v. *Speirway Ltd.* (1974) 1 W.L.R. 1648 at p. 1652, as follows:

``What is the basis of the doctrine of subrogation? It is simply that, where A's money is used to pay off the claim of B, who is a secured creditor, A is entitled to be regarded in equity as having had an assignment to him of B's rights as a secured creditor. There are other cases of subrogation where B is not secured, but the ordinary and typical example is as I have stated. It finds one of its chief uses in the situation where one person advances money on the understanding that he is to have certain security for the money he has[941] advanced, and, for one reason or another, he does not receive the promised security. In such a case he is nevertheless to be subrogated to the rights of any other person who at the relevant time had any security over the same property and whose debts have been discharged, in whole

or in part, by the money so provided by him, but of course only to the extent to which his money has, in fact, discharged their claims.''

The foregoing dicta are, no doubt, to be read and understood subject to the later exposition by Lord *Diplock* in *Orakpo* v. *Manson Investments Ltd.* (1978) A.C. 95 at p. 104, where he said:

``One of the sets of circumstances in which a right of subrogation arises is when a liability of a borrower B to an existing creditor C secured on the property of B is discharged out of moneys discharged by the lender L and paid to C either by L himself at B's request and on B's behalf or directly by B pursuant to his agreement with L. In these circumstances L is prima facie entitled to be treated as if he were the transferee of the benefit of C's security on the property to the extent that the moneys lent by L to B were applied to the discharge of B's liability to C. This subrogation of L to the security upon the property of B is based on the presumed mutual intentions of L and B; in other words where a contract of loan provides that moneys lent by L to B are to be applied in discharging a liability of B to C secured on property, it is an implied term of that contract that L is to be subrogated to C's security.''

Lord *Diplock* went on to say, at p. 105, that the mere fact that money lent has been expended upon discharging a secured liability of the borrower does not give rise to any implication of subrogation unless the contract under which the money was borrowed provides that the money is to be applied for this purpose: *Wylie* v. *Carlyon* (1922) 1 Ch. 51. Referring to the judgment of *Eve* J. in *Wylie v. Carlyon, Oliver* J. in *Paul* v. *Speirway Ltd. (in liq.)* (1976) Ch. 220 at p. 230, said:

``what I think *Eve* J. was saying was that the mere fact that you provide the money which goes to pay off somebody else's debt does not entitle you to be subrogated to the creditor whose debt is paid. There must, I think, be something more.''

It appears from the authorities that the ``something more'' must be found in the arrangements made by the borrower, the new lender, and the existing creditor, and from the expressed or presumed intention of all or some of them discerned from those arrangements: see the speech of Lord *Keith of Kinkel* in *Orakpo,* at p. 119.

In the present case there can be no doubt that the common intention of all parties was that the advance made by the plaintiff was to be applied to discharge the liability of NSCA to RAL. In circumstances like that where a prospect of subrogation arises, the question will generally be, as I think it is in this case, whether the terms of the loan agreement between the borrower and the new lender are sufficient to demonstrate an intention that the security for the debt paid out by the new loan should not be kept alive if the new lender's security should prove for some reason to be ineffective.

Lord *Diplock* pointed out in *Orakpo,* at p. 105, that the origin of the right of subrogation of the kind now under consideration is the contract of loan between the borrower and the new lender. Even when the contract provides (expressly or by implication) that the new loan will be used to pay off an existing secured debt, a presumed intention that the new lender is to have the security of the existing creditor may be displaced by inconsistent provisions in the contract of loan. The mere fact, however, that the contract of loan contemplates that the new lender is to obtain a specific new security from the borrower will not necessarily displace the doctrine of subrogation. Thus, in the *Ghana Commercial Bank case* the bank, a new lender, was to have had a legal mortgage over certain land to secure a loan it provided to enable the borrower to discharge an equitable mortgage previously given over the same land in favour

of another. A legal mortgage was executed but was held to be invalid. The Judicial Committee took the intention of the bank to have been to replace the equitable charge by a valid and effective legal mortgage but to keep the equitable charge alive and to have the benefit of it save in so far as it was so replaced. Part of the dictum of *Walton* J. quoted above is consistent with that approach, namely that the doctrine applies where there is an advance *on the understanding* that the lender is to have[942] certain security for the money he has advanced and, for one reason or another, he does not receive the promised security. As *Scott* J. observed in *In re Tramway Building & Construction Co. Ltd.* (1988) 1 Ch. 293 at p. 307, the intention attributed to the bank by the Judicial Committee:

``was not an actual intention, either express or to be inferred. It was an assumed intention which their Lordships thought the bank would have held if it had had in mind the invalidity of the legal mortgage.''

In the *Ghana Commercial Bank case* the bank's promised security was to be over the same property as that which had secured the debt paid out. In the present case the property over which the plaintiff intended to take security from NSCA was not the same as that in respect of which it now claims a security by way of subrogation to the rights of RAL. Counsel for the liquidator has submitted that that makes a difference. His submission was that any presumed intention to keep RAL's security alive is displaced by an expressed and inconsistent condition that the plaintiff was to have its own security over different property from that over which RAL had its security. If an agreement by the new lender to take a different security over the same property as that already charged is by itself insufficient to displace a presumption to keep the existing security alive, I see no necessary reason why an agreement to take security over different property should do so. Moreover, the cases of *Chetwynd* v. *Allen* (1899) 1 Ch. 353 and *Butler* v. *Rice* (1910) 2 Ch. 277 appear to be inconsistent with the submission. In the latter of these the plaintiff lent money for the purpose of enabling the borrower to pay off a debt owed to a bank charged on two parcels of land but he understood that the debt was charged upon one parcel only. The plaintiff was to receive as security for his loan a mortgage over the parcel of land he had understood to be charged to the bank, and a guarantee. The plaintiff made the loan and the bank was paid off but the mortgage in his favour was not executed. One question to be decided was whether the plaintiff was entitled to treat the bank's mortgage as still on foot in his favour. *Warrington* J. held that the fact that the plaintiff intended, if the transaction had been carried out, to have a legal mortgage over one property only and a guarantee did not mean that the plaintiff should not be presumed to keep the bank's mortgage on foot for his own benefit. The plaintiff intended to have a different security from that which the bank had had but, said *Warrington* J. at p. 283:

``that is not evidence that he intended in the meantime to give up such security as the transfer of the deeds to him would give him.''

Both *Chetwynd v. Allen* and *Butler v. Rice* were cited in the *Ghana Commercial Bank case,* apparently as justifying the conclusion that, on the facts of that case, it was not the intention of the bank that the equitable charge should be extinguished ``in the event of the legal mortgage proving for any reason to be invalid or ineffective''. So here, I think it may equally be said that, although the plaintiff intended to take a chattel mortgage from NSCA over specified property, that was not sufficient to displace what Lord *Diplock* called ``the presumed mutual intentions'' of the plaintiff and NSCA that the RAL security should be kept alive for the plaintiff's own benefit save in so far as it was replaced.

That conclusion is, I think, supported by the speech of Lord *Keith of Kinkel* in *Orakpo.* The case was one in which a moneylender had advanced money for the purchase of property and had obtained a legal

mortgage to secure repayment. The legal mortgage was void because it infringed provisions of the *Moneylenders Act.* The moneylender claimed to be subrogated to the benefit of the vendor's equitable lien which the advance had discharged. The claim failed because of the terms of the Act but it seems that otherwise the moneylender would have succeeded in keeping the vendor's lien alive, and this notwithstanding that the moneylender had stipulated for a different security from that to which it claimed to be subrogated. Lord *Keith of Kinkel* said at p. 120:

``It is then necessary to consider the position in the case where the contract of loan stipulates for some fresh security to be given to the moneylender, but it is still the common intention of the parties that the money lent should be used to pay off existing charges. In my opinion that common intention forms one of the terms of the contract, which may in certain circumstances have important legal[943] consequences, and is required to be set out expressly in the note or memorandum. If for any reason the security stipulated for should prove to be invalid, then subrogation to the pre-existing security rights would arise, and these rights would, in my opinion, be given by the borrower to the lender, by virtue of the contract into which he had entered, after signing the note or memorandum.''

The property that was to be the subject of the legal mortgage for which the moneylender stipulated was of course the same property that had been the subject of the equitable lien to which the moneylender claimed to be subrogated. That, however, was not material to the point of his Lordship's remarks. The property interest stipulated for in the money-lending contract and the property interest claimed by way of subrogation were security interests only, and they were different. That difference would not have prevented the operation of the doctrine of subrogation had it otherwise been applicable.

The answer to the question whether there is an intention to be discerned that an existing security should not be kept alive may be influenced by the effect of a presumed intention on the respective positions of the lender, the borrower and the existing creditor. In the present case the existing creditor, RAL, cannot be at all affected because it has been paid out in full. So far as the liquidator of NSCA is concerned he could not legitimately complain if the security interest of RAL were kept alive in favour of the plaintiff inasmuch as it was by the conduct of Friedrich that the plaintiff was led into paying RAL without obtaining the security it was promised: the liquidator, of course, can be in no better or different position than NSCA had it not been in liquidation. Had the plaintiff not paid out RAL's debt, RAL would have been entitled to claim in the winding up as a secured creditor, and it seems to me to be entirely fair that the plaintiff should now be entitled to do so. Indeed, it would be positively unfair if the plaintiff should not, and that the unsecured creditors as a whole should, enjoy a windfall equal to the amount of the plaintiff's advance. Reason and justice demand that the doctrine of subrogation should apply in favour of the plaintiff: cf. *Orakpo* at p. 110, per Lord *Salmon.* I propose to allow the plaintiff's claim against the liquidator accordingly.

I shall hear counsel upon the form the judgment should take. Subject to counsels' submissions I would propose that in proceeding numbered 118 of 1989 the first-named defendant should have judgment against the plaintiff with costs, including costs reserved. There should be a declaration to the effect that the plaintiff is entitled to the rights of the first-named defendant under the deed of charge dated 10 February 1987 between the first-named defendant and the second-named defendant referred to in para. 3D of the further amended statement of claim, so far as the plaintiff is otherwise unsecured for its advance made to the second-named defendant on 17 February 1989. The plaintiff should have its costs of the proceeding as between the plaintiff and the second-named defendant and the third-named

defendant, such costs to be costs in the winding up. The costs and expenses of the third-named defendant, the liquidator, should be costs in the winding up.

In proceeding numbered 271 of 1989, which was heard together with the other proceeding, there is a summons in which the liquidator is applicant and RAL is respondent, and there is a cross-summons by RAL against the liquidator. Both summonses seek directions in relation to the said deed of charge given to RAL by NSCA. Most if not all of the questions raised would appear now to have been overtaken but, again, I shall hear counsel as to the orders that should be made.