

Cheah Theam Swee

Appellant

v.

Equiticorp Finance Group Limited and  
Equiticorp Nominees Limited

Respondent

FROM

THE COURT OF APPEAL OF NEW ZEALAND

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JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE  
OF THE PRIVY COUNCIL, DELIVERED THE  
13TH NOVEMBER 1991  
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*Present at the hearing:-*

LORD KEITH OF KINKEL  
LORD GRIFFITHS  
LORD ACKNER  
LORD BROWNE-WILKINSON  
SIR MICHAEL KERR

*[Delivered by Lord Browne-Wilkinson]*

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This appeal from the Court of Appeal of New Zealand raises a short question of principle: where there are two mortgages of the same property, can the mortgagees effectively agree to alter the priorities of the mortgages without the consent of the debtor?

The factual background is complicated, but for the present purposes the salient facts can be shortly stated. By a mortgage deed ("Mortgage I") the appellant ("the debtor") covenanted to pay certain sums of money to a company, Equiticorp Securities Limited, and as security for such payment charged 14 million shares in London Pacific Limited "by way of fixed first charge". By a further mortgage deed ("Mortgage II") the debtor covenanted to pay certain further sums to Capitalcorp Investments Limited and as security for such payment charged, *inter alia*, the same 14 million shares in London Pacific Limited "by way of second fixed charge". By a series of transactions both the mortgages became vested in the respondent Equiticorp Finance Group Limited. In December 1987 the respondent obtained judgment against the debtor for the sum of \$7,556,442.47, being monies the payment of which was secured by Mortgage I.

The respondent then exercised its power of sale under Mortgage II over, *inter alia*, the 14 million shares in London Pacific Limited. Apparently it was overlooked that those shares were subject to a first charge under Mortgage I. The shares were not sold subject to Mortgage I. The proceeds of sale of the shares were applied by the respondent, not in satisfying the monies due under Mortgage I (being the judgment debt), but in or towards discharging the debts secured by Mortgage II. The Court of Appeal treated the respondent as having waived its priority under Mortgage I and this was not challenged before their Lordships' Board.

The debtor took the view that he was entitled to insist that the proceeds of sale should have been applied in the order laid down by the original mortgages, in which case the judgment against him would have been fully satisfied. He therefore applied to the High Court under Rule 544 for an order that the judgment had been fully satisfied.

The case came before Wylie J. who decided in the debtor's favour. The Court of Appeal reversed that decision and held that the respondent, as the holder of both mortgages, could unilaterally decide whether to apply the proceeds of sale of the London Pacific Limited shares in satisfaction of Mortgage I or Mortgage II. It is from that decision that this appeal is brought.

The following extract from the judgment of Wylie J. shows the grounds on which he held in the debtor's favour:-

"Every mortgage is a contract, albeit one with special characteristics by reason of the charge it creates. In the case of successive mortgages each of them the first mortgagee and the second mortgagee has a contractual relationship with the mortgagor. Each has, by lending on the security of, and accepting the mortgage, created and accepted rights and duties between the mortgagor and the mortgagee. But there is no contract between the two mortgagees, and no arrangement between them can by unilateral act by each as against the mortgagor alter the terms of his contract with the mortgagor. By giving a first mortgage to the one and a second to the other the mortgagor has defined the rights of each in relationship to himself. While either mortgagee may deal with his mortgage - e.g., sell it, or sub mortgage it, he cannot unilaterally alter his contract with the mortgagor and the mortgagor cannot be affected by any such dealing. If two successive mortgagees agree amongst themselves to deal with the proceeds of sale on a mortgagee's sale that may be a valid and enforceable transaction as between themselves but they cannot do so to the prejudice of the mortgagor."

In contrast, the Court of Appeal emphasised the right of a mortgagee to pursue his various remedies alternatively and cumulatively: if a mortgagee chooses to enforce a personal covenant for repayment, he is entitled to do so and is not bound first to realise his security. Moreover, by choosing to waive his priority a first mortgagee is not varying or prejudicing the mortgagor's right to redeem. In no circumstances can the mortgagor recover the mortgaged property until all the debts secured on it have been satisfied. Therefore there is no need for a mortgagor to consent to any variation in the priorities.

Their Lordships would have been content to adopt the reasoning of the Court of Appeal. But in deference to the arguments of counsel and because there is no Commonwealth decision on a point which is of practical importance in relation to the subordination of debts, the Board think it desirable to state shortly their own reasons.

The question must be approached on the basis that Mortgage I and Mortgage II had remained vested in two separate mortgagees. The respondent, as holder of both mortgages, cannot be in a better position than the original mortgagees. The question therefore is whether two mortgagees can, without the consent of the mortgagor, agree to vary the priority of their mortgages. In the ordinary case, the mortgagor is not affected by the order in which his debts are satisfied. The mortgagor is bound to satisfy all his secured debts before he can recover the mortgaged property. In the ordinary case priority of mortgages affects only the rights of the mortgagees inter se, in particular where the security is inadequate to pay all the secured debts in full.

Moreover, the mortgagor has no right to insist on the mortgagee pursuing one of his remedies rather than another. It is for the mortgagee to decide whether to rely on the personal covenant for payment, or to sell the security or to take possession of the mortgaged property. So, in the present case, Mortgagee I was fully entitled to sue the debtor on his personal covenant and rely on that alone. Mortgagee I could, if he chose, abandon or waive his security to the benefit of both Mortgagee II and the debtor: the debtor had no right to insist that Mortgagee I enforce his debt against the security.

The one matter that the mortgagor can insist upon is that, on redemption by payment, he gets back his security. That is the explanation of the principle in *Palmer v. Hendrie* (1859) 27 Beavan 349 that a mortgagee cannot sue on the mortgagor's personal covenant of payment if the mortgagee has put it out of his power to restore the mortgaged property on

repayment of the debt: see also *Trustee of the Property of Ellis & Co. v. Dixon-Johnson* [1925] A.C. 489 at 491.

Mr. Dugdale, for the debtor, sought to rely on that principle in the present case. He submitted that, by reason of Mortgagee I agreeing to waive or postpone its priority, the debtor was precluded from recovering the mortgaged property on paying the sum secured by Mortgage I: Mortgagee I, by permitting Mortgagee II to apply the proceeds of sale in satisfaction of the debt secured by Mortgage II, had prevented Mortgagee I from returning the security to the debtor. Their Lordships do not accept this argument. Even if there had been no alteration in the priorities and the debtor had paid the sums secured by Mortgage I, the debtor would not have been entitled to recover the mortgaged property until the debt secured by Mortgage II had been paid. The alteration in priorities did not adversely affect the debtor's rights to recover his security.

For these reasons, in the ordinary case a mortgagor has no right to insist on the order in which successive mortgaged debts are satisfied. This is the answer to the otherwise compelling reasoning of Wylie J. The provisions in Mortgage I describing the charge as a "first charge" are merely a description of the nature of the security which the debtor was giving: it did not confer on the debtor a contractual right to insist on the satisfaction of his debts in any particular order. There may be cases (for example where the successive mortgages carry differing rates of interest) where the mortgagor has a genuine interest in ensuring that the debts are satisfied in a particular order. In such a case it will be for the mortgagor to insist upon a specific contractual provision precluding the alteration of the priorities of the mortgages.

Their Lordships' conclusions accord both with what they understand to be the generally accepted view of the law affecting subordination of debts and the law of the United States: see 59 *Corpus Juris Secundum* para. 218; *Putnam v. Broten* (1930) 60 ND 97; 232 NW 749. It is manifestly desirable that the law on this subject should be the same in all common law jurisdictions.

Their Lordships will accordingly humbly advise Her Majesty that the appeal ought to be dismissed. The appellant must pay the respondent's costs before their Lordships' Board.