論　　説

RECONSIDERATION OF TAKING CHARGE ON DEPOSITS IN BANK ACCOUNTS IN ENGLAND*

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Chapter I Introduction

For banks or other financial institutions, it might be attractive to charge their customers or third parties for their cash deposits. In fact, it is said that bankers consider a charge over a deposit as a nearly perfect security[1]. This implies that a bank can take a charge over its own indebtedness. This type of security, known as 'charge-back', has triggered a debate over its conceptual validity and legality for a long time[2].

In Re Charge Card Services Ltd[3], Millett J claimed that charge-back is "conceptually impossible", and banks cannot take a charge over their own indebtedness to depositors[4]. The explanation was that a charge-back would have the objectionable result of putting the chargee in a position to sue himself

1 Joan Benjamin, *Financial Law* (Oxford University Press 2007) at 470,

2 Diccon Loxton, 'One flaw over the cuckoo's nest- Making sense of the 'flawed asset arrangement' example, security interest definition and set-off exclusion in the PPSA' (2011) 34 (2) UNSW Law Journal 472

3 *Re Charge Card Services Ltd* [1987] Ch. 150 (CA),

4 Ibid at 175

as debtor and would take effect as a release of the debt. From the case of *Halesowen Press work & Assemblies Ltd. v National Westminster Bank Ltd*[5], it can be considered that creating a charge over deposits would do no more than create a right of set-off. After this decision, bankers began to realise the fact that a charge over their customers' deposits was no longer the perfect security they had expected. They ensured that their security incorporated what became known as the 'triple cocktail' which combines charge-back, rights of set-off and a flawed asset arrangement. *Re BCCI (no.8) case*[6] followed *Re Charge Card Services case*[7] both in the lower court[8] and in the Court of Appeal[9]. However, in the House of Lords[10], it was not followed.

Lord Hoffmann, in his decision, made it clear that it was possible to take a charge over one's own indebtedness, if that was the intention of the parties involved. This dispute generally has been regarded to be resolved by Lord Hoffmann's opinion[11]. Although his opinion seems to be the final word, some problems remain unsolved regarding 'charge-back'[12]. For example, a registration question: is charge-back a charge under section 395 of the Companies Act 1985, if created by a company over its book debts? Is it a contractual security or proprietary security? Moreover, 'whether the existence

5 *Halesowen Press work & Assemblies Ltd. v National Westminster Bank Ltd* [1971] 1 QB 1 (CA), at 46

6 See. following footnote 8, 9, 10

7 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

8 *Re Bank of Credit and Commerce International S.A. Ltd.* [1994] 3 ALL ER 565 (Ch. D)

9 *Re Bank of Credit and Commerce International S.A. Ltd.* [1996] 2 ALL ER 121 (CA)

10 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL)

11 Benjamin, *Financial Law* (n1) at 153

12 Benjamin, *Financial Law* (n1) at 153-165; Rizwaan J. Mokal, 'Resolving the MS Fashions "Paradox"' (1999) 3 (1) Company Financial and Insolvency Law Review 106

of a charge in one's favour over one's own indebtedness (a "charge-back") destroys the mutuality necessary for insolvency set-off to operate' [13].

Furthermore, according to Benjamin (2007), the debate regarding creating security over one's own indebtedness or taking security over bank account continues. One view is that these charges are conceptually impossible for several reasons[14], and another view is that it was commercially desirable that banks should be able to take charge-backs, and in practice, many bankers have already done it. The latter reasoning aligns with Lord Hoffmann's opinion in *Re BCCI (no.8)*. However, this reasoning seems to be weaker than the former one, because it only considers the practitioners' opinion. Therefore, it is difficult to conclude that this dispute was resolved by Lord Hoffmann's opinion.

As this dispute has not been settled yet, analysis of the case law is important. Additionally, since unsolved problems concern cases in which charge on deposit account exists and/or cases regarding the nature of such transaction, examining the effect of charge that exists over deposit in bank account on charge-back seems to be a fruitful research agenda. In this article, I examined the abovementioned problems by reevaluating the existence of charge on deposits in bank accounts.

This article is structured as follows. Chapter II is divided into two sections. The view of case law that agrees with the charge-back and the view of case law that disagrees with the charge-back will be examined. Following this, Chapter III discusses the existence of charge-back and related issues. Chapter IV describes and examines the 'triple cocktail' and issues regarding a charge-back. Finally, Chapter V concludes the article with some suggestions.

13 Mokal (n12) at 106

14 Benjamin, *Financial Law* (n1) at 151. These reasons will be detailed described in Chapter IV.

Chapter II Charge-back and Conceptual Impossibility Arguments

2.1 Case law

2.1.1 Cases Against Charge-back

As mentioned in Chapter 1, there has been a theoretical debate among judges and legal scholars about the legal nature of charge-back and its conceptual possibility. Although the doctrine of conceptual impossibility regarding charge-back was propounded by Millett J in *Re Charge Card Security Ltd*[15], which is one of the key decisions about charge-back issues, arguments of taking security over the bank account were also raised before that. The argument against the charge-back is based on cases dealing with other securities such as leases or mortgages[16].

The *Rye v Rye case*[17], which was a tenancy case, denied that one could grant a lease to oneself[18]. In this case, section 72 (3) of the Law of Property Act 1925[19] was questioned. It stipulates that 'after the commencement of this Act, a person may convey land to himself'. The court answered the question of whether or not this section enabled an individual to grant a lease or mortgage to themselves. This section did not permit a person to grant a lease of land to themselves. The difficulty of this case lay on interpretation of the term 'convey' in section 72 (3). Lord Denning states that 'it is better to give a different content to the word "convey" in section 72 (3) than to admit into the law such a fantastic notion as that a man can grant a tenancy to himself. It is a case when the context requires

15 *Re Charge Card Services Ltd* [1987] Ch. 150 (CA) (n3)

16 Edwin C. Mujih, 'Legitimising charge-backs' (2001) 1 Insolvency Lawyer 3

17 *Rye v Rye* [1962] A.C. 496 (HL)

18 It is said that this case applied *Grey v. Ellison* ([1856] w Giff 436 (Vice Chancellor's court)), which indicated that a man should not provide a lease to himself.

19 The Law of Property Act 1925 (1925 Chapter 20)

us to limit the definition of 'convey'[20]. This interpretation of the section was considered to be consistent with common law's position, which meant that an individual cannot contract with themselves. Accordingly, this position would also be applicable to the concept of charge-back[21].

In Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd.[22], Buckley LJ states that 'no man can have a lien on his own property and consequently no lien can have arisen affecting that money or that credit'[23] and 'I cannot myself understand how it could be said with any kind of accuracy that the bank had a lien upon its own indebtedness to the company'[24]. In addition, in the decision of the House of Lords in this case[25], Lord Cross indicates that 'I agree with Lord Denning MR and Buckley L.J. that a debtor cannot sensibly be said to have a lien on his own indebtedness to his creditor'[26].

In Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd.[27], Goode (1998)[28] argues that this case is different from charge-back case because it is related to the impossibility to exercise a lien[29]. Although this case deals with a lien which differs from charge regarding attachment to tangible property and a right to retain possession, the reason why judges of the Court of Appeal

20 *Rye v Rye* [1962] A.C. 496 (HL) (n17), at 510; Lord Radcliffe was concurring with this.

21 Mujih (n16), at 8

22 *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1971] 1 Q.B. 1 (CA) (n5)

23 Ibid at 46

24 Ibid at 46

25 *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1972] AC 785 (HL)

26 Ibid 810

27 *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1971] 1 Q.B. 1 (CA) (n5)

28 Roy Goode, *Commercial Law in the Next Millennium* (Sweet & Maxwell 1998)

29 Roy Goode, *Commercial Law in the Next Millennium* (n 28) at 69-70

and House of Lords deny creating a lien over own indebtedness (bank account) to their customer might not be the nature of security[30]. It is possible to suppose that the judges discuss the issues regarding the relationship between the debtor and the creditor. In other words, the judges might indicate that it is difficult for banks to take security between two parties which are the creditor and the debtor, whether it is a charge or a lien. This case was applied by the Supreme Court of Australia in *Broad v. Commissioner of Stamp Duties*[31] and *Re Charge Card Services Ltd*[32].

In *Re Charge Card Service Ltd*[33], the summary of the facts is as follows. A company operated a scheme for purchasing petrol from the approved garages using the charge cards it issued. The company went into voluntary liquidation and owed amount to garages that had supplied petrol for returning vouchers signed by card holders. Card holders, who had utilized their charge cards to purchase goods before the date of liquidation also owed a large amount to the company[34].

Millet J states that 'a charge in favour of a debtor his own indebtedness to the chargor is conceptually impossible' [35]. The reason for this[36] is that a deposit is a liability or a debt owed by a bank (a debtor) to the depositor (a creditor) and 'a debt is a chose in action; it is a right to sue a debtor' [37]. That is to say, the

30 *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1972] AC 785 (HL) (n 25); *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1971] 1 Q.B. 1 (CA) (n5)

31 *Broad v. Commissioner of Stamp Duties* [1980] 1 N.S.W.L.R. 40 (SC)

32 *Re Charge Card Services Ltd* [1987] 1 Ch 150 (CA) (n3)

33 *Re Charge Card Services Ltd* [1987] 1 Ch 150 (CA) (n3)

34 Basically, this case was the liquidator's challenging of the terms of the factoring agreement.

35 Benjamin, *Financial Law* (n1) at 175

36 Benjamin, *Financial Law* (n1) at 175-176

37 Benjamin, *Financial Law* (n1) 176

creditor cannot take such security because they cannot enforce the security by an action against themselves.

After this case, it became highly controversial among legal scholars, and Millett J's view was not welcomed by some legal scholars and practitioners[38]. In general, practitioners regarded it as just a theoretical problem and, by ignoring the judgment[39], continued their business as usual taking charges over their customers' bank accounts like before.

It is argued that Millet J adopted the view of Professor Roy Goode[40] and the statement of Buckley J in *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd.*[41]. Goode (2009)[42] argues in his first two editions that taking security over receivables needed three parties: the debtor, creditors and the creditor's assignee or other encumbrancer[43]. He debates that 'it was conceptually impossible for the debtor to be given a security interest over his own obligation to his creditor[44] because between creditor and debtor, a debt

38 Graham Rowbotham 'Can banks secure their own deposits?' (1987) 6 Int'l Fin L. Rev. 18, Philip Wood and Geoffrey Yeowart 'Court of Appeal denies concept of charge-back under English law' (1996) 15 Int'l Fin L Rev. 17, Geoffrey Yeowart 'House of Lords upholds charge-backs over deposits' (1998) 17 Int'l Fin L Rev. 7

39 Graham Rowbotham (n38) at 18

40 Roy Goode, *Legal Problems of Credit and Security* (2nd edn, Sweet & Maxwell 1988)

41 Sheelagh McCracken, *The Banker's Remedy of Set-Off* (Third edn, Bloomsbury Professional Ltd 2010) 263: However, the interpretation of the opinion of Buckley J by Millet J was said to be controversial

42 Roy Goode, *Goode on Legal Problems of Credit and Security* (4th edn, Sweet & Maxwell 2009)

43 Ibid at 102

44 Ibid at 102; This approach seemed to affect *Re Charge Credit Security Ltd* case and Goode himself mentioned that "This approach was adopted four years later by Millet J. in *Re Charge Card Security Ltd,* a decision subsequently endorsed by the Court of Appeal (albeit by way of *obiter dicta*) in Re Bank of Credit and Commerce International SA (no.8)" *See.* Roy Goode, *Commercial Law in the Next Millennium* (n 28) at 69

is not a species of property but an obligation. Further, it is also because the creditor purporting to take security interest cannot sue himself.

After these cases, the decision by the Court of Appeal, *Morris v Agrichemicals*[45], that is, *Re BCCI SA* (*no.8*) case appeared. The facts are as follows. BCCI had advanced loans to companies, customers and principal debtors. The depositor had deposited money and charged the deposit by repaying the loan. BCCI did not obtain a covenant or guarantee of repayment form the depositor. Then, BCCI went into liquidation before the loan was repaid.

Rose J's decision supports the position of Millet J in *Re Charge Card Service Ltd*[46]. Rose J carefully reviews the ways to characterise the nature of a charge-back using primarily two approaches: the conceptual approach and the policy approach[47]. He states that a charge-back cannot be a charge in the true sense of the term because it cannot create any proprietary interest in the assets. Furthermore, the court confirmed that a charge-back did not mean a charge within the scope of section 395 of the Companies Act 1985[48], nor did it require registration. In this context, the nature of charge-back can be characterised as contractual interest rather than proprietary interest[49].

2.1.2 Pro Charge-back Cases

There is another line of case law concerning the creation of security including lien, that is, mortgage over one's own indebtedness. In *British Eagle International*

45 *Re Bank of Credit and Commerce International SA* (*no.8*) (*Morris v Agrichemicals*) [1996] Ch 245 (CA) (n7)

46 Millet J was a member of three judges in *Re BCCI* case.

47 *Halesowen Preswork & Assemblies Ltd v. National Westminster Bank Ltd* [1971] 1 Q.B. 1 (CA) (n5) at 257-261

48 the Companies Act 1985 (1985 chapter 6)

49 Mark Evans 'Case comment: Decision of the Court of Appeal in Morris v Agrichemicals Ltd: a flawed asset?' (1996) 17 (4) Company Lawyer 102 at 104

Airlines Ltd v. Compagnie Nationale Aile France[50], the House of Lords approved the efficacy of charges over loyalties. *Webb v. Smith*[51], which treats a lien of an auctioneer over client's money, follows the position of the *British Eagle case*[52] and it is said that the court intended to support the validity of charge-back[53]. However, these cases are not concerned with charge-back.

Although the creation of charge-back is not the primary issue, charge-back is supported in court reasoning in cases such as *Ex p Caldicott*[54]*, Re National Bank of Wales Ltd*[55]*, Bower v. Foreign and Colonial Gas Co*[56]*, and Rodick v. Gandell*[57]. *In Rodick v. Gandell,* Lord Truro states that 'the extent of the principle to be deduced from them is, that an agreement between a debtor and a creditor that the debt owing shall be paid out of a specific fund coming to the debtor, or an order given by a debtor to his creditor upon a person owing money or holding funds belonging to the giver of the order, directing such person to pay such funds to the creditor, will create a valid equitable charge upon such fund; in other words, will operate as an equitable assignment of the debts or fund to which the order refers"[58]. This statement was cited in the cases that followed[59].

After these cases, Dillon LJ in *Welsh Development Agency v Export Finance*

50 *British Eagle International Airlines Ltd v. Compagnie Nationale Aile France* [1975] 2 ALL E.R. 390 (HL)

51 *Webb v. Smith* [1885] 30 Ch.D 192 (CA)

52 *British Eagle International Airlines Ltd v. Compagnie Nationale Aile France* [1975] 2 ALL E.R. 390 (HL) (n50); it follows not only this case but *Re Ex p Brown; Ex.p Mackay* (*Jeavous*) ([1873] L.R. 3 Ch.App. 634).

53 Mujih (n16) at 7

54 *Ex p Caldicott* (*Hart*) [1884] 25 Ch.D 716 (CA)

55 *Re National Bank of Wales Ltd* [1989] 2 Ch. 629 (CA)

56 *Bower v. Foreign and Colonial Gas Co Ltd, Metropolitan Bank, Garnishees* [1874] 22 W.R. 740 (pre-SCJA 1973)

57 *Rodick v. Gandell* [1852] 42 E.R. 749

58 Ibid at 777-778

59 *Palmer v. Carey* [1926] A.C. 703 (PC (Australia))

Co Ltd[60] states that 'as far as the decision in *Re Charge Card Services Ltd* [1987] BCLC 17 at 39, [1987] Ch 150 at 175 is concerned, I have very considerable difficulty with the view expressed by Millett J that a book debt due to the company (Charge Card Services Ltd.) from Commercial Credit could not be charged in favour of Commercial Credit itself because a charge in favour of a debtor of his own indebtedness to the chargor is conceptually impossible'[61]. Thus, he does not apparently decide about this point and leaves the question still open[62].

Finally, in the House of Lords of *Re BCCI SA* (no.8)[63], Lord Hoffmann reversed *Re Charge Card Service* and the decision of the Court of Appeal mentioned above. Lord Hoffmann states that 'the courts should be very slow to declare a practice of the commercial community to be conceptually impossible'[64]. However, this statement is a part of *obiter dictum,* and it remains unclear how this statement might impact the future cases, even though it had an effect on the doctrine of conceptually impossibility dispute.

Thus, there are two lines in case law concerned with charge-back. However, the House of Lords of *BCCI (no.8) case*[65] is the only case that directly affirms the efficacy of charge-back over the deposit in a bank account. Hereafter, no cases concerned with this issue have been identified in England[66]. Therefore, even though this case is considered to be the latest case, whether or not the court has confirmed that it is possible to take a charge over the deposit remains open. This

60 *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148

61 Ibid at 166

62 Timothy Parsons, *Lingard's Bank Security Documents* (5th edn, Lexis Nexis 2011) at 441, Sheelagh McCracken (n 41) at 262-263

63 *Re Bank of Credit and Commerce and International SA (no.8)* [1997] 4 All E.R. 568 (HL) (n 8)

64 Ibid at 578

65 Ibid

66 In Australia, there are several cases about this.

uncertainty persists because the part of the case affirming this point was obiter dictum. Accordingly, among scholars and commentators, conflicting opinions continue on pro-charge-back and anti-charge-back.

2.2 Conceptual Impossibility Argument

Since the banking community has supported the view of Lord Hoffmann, bankers and practitioners seem to have accepted this decision[67]. McKnight (2008)[68] states that this controversial argument was originally propounded by Millett J in *Re Charge Card case*[69]. As for this point, Goode (1994)[70] also states that 'though the decision was controversial, it is correct'[71]. He stresses that both conceptual problems of charge-backs and the policy issues should be discussed. He originally contends that the granting security over receivables requires three parties, such as the debtor, the creditor and the creditor's assignee or other encumbrancer[72]. Furthermore, he agreed with the view of Millett J in *Re Charge Card case*[73], that is, conceptual impossibility of taking security over own indebtedness. This is because the creditor who takes a security interest cannot sue himself or cannot appoint receiver for the purpose of collecting from himself[74]. In addition, he points out that 'a debt is not a species of property,

67 *Re Bank of Credit and Commerce and International SA (no.8)* [1997] 4 All E.R. 568 (HL) (n 8) at 576; Joanna Benjamin, *Interests in Securities* (Oxford University Press 2000) at 110

68 Andrew McKnight, *The Law of International Finance* (Oxford University Press 2008)

69 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

70 Roy Goode, 'Charge over Book Debts: A Missed Opportunity' (1994) 110 LQR 592

71 Goode, 'Charge over Book Debts: A Missed Opportunity' (n 70), at 606

72 Goode, *Goode on Legal Problems of Credit and Security* (n 42) at 102

73 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

74 Ibid at 102-103

merely an obligation'[75].

Moreover, Goode (2009)[76] states that 'there are two ways of approaching the characterization of charge-backs: the conceptual approach and the policy approach. It suggests that at the conceptual level Lord Hoffmann's analysis does not withstand examination and is entirely result-driven, whilst the policy objections were not explored at all'.[77] Furthermore, he claims that Lord Hoffmann needed to assign the concept of a proprietary interest to a new meaning, that is, charge is enforced by book-entry[78].

On the other hand, Wood (1987)[79] opposes the opinion of Millett J. He says that 'a debt is a chose in action, or a right to sue the debtor, so that, if this is assigned to the debtor, he cannot sue himself. But the law has for a long time recognized that there is no objection to a debtor holding his own debt even though he cannot sue himself. One example is the law merchant in the form of section 37 of the Bills of Exchange Act 1882[80] which enables a bill to be negotiated to the acceptor and to be renegotiated by him'[81]. Moreover, he contends that the emphasis on the characteristic of a debt as a procedural feature is too narrow. He argues that 'Defining a debt as merely a right to sue would be like defining the ownership of goods as a right to possession'[82].

75 Ibid at 102

76 Ibid

77 Roy Goode, 'Charge-backs and legal fictions' (1998) 114 LQR 178 at 178

78 Ibid

79 Philip Wood, 'Three Problems of Set-off: Contingencies, Build-Ups and Charge-backs' (1987) 8 (6) Company Lawer 262

80 The Bills of Exchange Act 1882 (1882 Chapter 61)

81 Wood, 'Three Problems of Set-off: Contingencies, Build-Ups and Charge-backs' (n 79) at 267

82 Ibid at 267

Oditah (1991)[83] shares a similar stance with Wood (1987)[84], explaining that it is not persuasive that a debt is a chose in action. He indicates that Millett J's view has an inconvenient effect on business or commercial world and bankers. Benjamin (2007)[85] points out the legal risk that 'where existing collateral arrangements involving cash balances relied on Charge Card to escape registration, that escape route is no longer available'[86]. Contrastingly, Roberts (2009)[87] points out that a bank requires to take a charge over deposits as an effective measure to stop the customer from withdrawing from the bank account (flawed asset arrangement) in the event of the customer's insolvency. In other words, a flawed asset arrangement is a valid means to achieve bankers' purpose. Simmonds (1998)[88] points out that there are still unresolved questions and issues, therefore, the further court decisions will be important[89].

2.3 Summary

Thus, there are two lines of case law concerned with creating security over one's own indebtedness. As previously mentioned, creating charge-back over one's own indebtedness might conflict with the common law, that does not accept the way that an individual contracts with oneself. Furthermore, Lord Hoffmann could not clearly explain the theoretical problem regarding charge-

83 Fidelis Oditah, *Legal Aspects of Receivables Financing* (Sweet & Maxwell 1991)

84 Wood, 'Three Problems of Set-off: Contingencies, Build-Ups and Charge-backs' (n 79)

85 Benjamin, *Financial Law* (n 1)

86 Ibid at 110

87 Graham Roberts, *Law relating to Financial services* (7th edn, Global Professional Publishing 2009)

88 Jeremy Simmonds, 'Case Comment: Charge Card revisited (for the last time?)' (1998) 13 (3) Journal of International Banking law 85

89 Ibid

back, even though his approach, that is, the way to consider the bankers and practitioners, is still effective. Lord Hoffmann's decision seems to follow one stream of case law. However, he did not indicate why he did not accept another stream which agrees with a charge-back. In other words, he did not overrule the previous cases, this is why the case law seems to be incoherent.

Chapter III Charge-back

3.1 Legal Nature of Charge-back

Although the view of Lord Hoffmann in *Re BCCI SA* (no.8)[90] is obiter dictum and does not strictly bind the lower courts, it holds true that taking a charge over the deposit in a bank account could be effective for banks[91]. McKnight (2008)[92] points out that set-off is sometimes not available due to the event of insolvency or mutuality matter. Furthermore, it is considered that since a charge holder has a preferential right to access the cash balance, they can take a more advantageous position compared to other quasi-security holders such as a person who has a right to set-off or to make the flawed asset agreement[93].

However, as mentioned in the previous chapter, a charge-back raises some questions and the courts have not solved these points yet. For example, is a charge-back truly a proprietary security interest just as a charge is? Does a charge-back possess same characteristics as a charge? If so, does a charge-back fall in the same category as a floating charge or a charge over book debts?[94]

90 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

91 McKnight (n 68)

92 Ibid

93 Paul A. U. Ali, *The Law of Secured Finance: an international survey of security interests over personal property* (Oxford University Press 2002)

94 Ruper Choat, "The return of the Charge-back" (1996) 55 Cambridge L.J. 438

As for the first question, Lord Hoffmann in *Re BCCI SA* (no.8) *case*[95] clearly says that a charge-back is a proprietary security interest. Furthermore, he explains that 'the depositor would retain an equity of redemption and all the rights which that implies. ... The creation of the charge would be consensual and not require any formal assignment or vesting of title in the bank. ...I cannot see why it cannot properly be said that the debtor has a proprietary interest by way of charge over the debt'[96]. According to this decision, Lord Hoffmann seems to consider a charge-back as a normal equitable charge and that the depositor has a right to redemption similar to a charge holder. Wood (2008)[97] follows this decision and clearly defines a charge-back as '...a grant by a creditor of a proprietary security interest over the claim owed to the creditor to secure the cross-claim the creditor owes to the debtor'[98]. Yeowart (1998)[99] also argues that 'the charge-back would create a proprietary interest capable of binding assignees and a liquidator of the depositor'[100].

However, Evans (1996)[101] contends that 'the court affirmed that a charge-

95 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

96 Ibid at 227

97 Philip Wood, *Law and Practice of International Finance* (University Edition) (Sweet & Maxwell 2008)

98 Ibid at 222

99 Yeowart, 'House of Lords upholds charge-backs over deposits' (n 38)

100 Ibid at 8

101 Mark Evans, 'Case Comment: Decision of the Court of Appeal in *Morris v Agrichemicals Ltd:* a flawed asset?' (1996) 17 (4) Company Lawer 102, at 104; This article was published before the decision of House of Lords. However, after the decision of *Re BCCI case* (HL), he wrote a case comment. (see. Mark Evans, 'Triple cocktail becomes single malt? Some thoughts on the practical consequences of the decision of the House of Lords in *Morris v Agrichemicals*' (1998) 13 (3) Journal of International Banking Law 115) However, he has not modified the approach of the nature of charge-back and categorisation of charge-back, so that his basic opinion concerning these points may not have changed.

back does not create and vest in the charge a proprietary interest in the debt which he owes to the chargor. Accordingly, a charge-back is not a charge within the meaning of section 395 of the Companies Act 1985 and does not require registration' [102]. Furthermore, he strongly argues that 'the categorisation of the interest of the 'chargee' under a charge-back as contractual, rather than proprietary, appeared to the court to be 'of little if any practical significant' [103]. It is because in the event of the insolvency, the deposit constitutes a part of the insolvent estate. This opinion also seems to be persuasive.

In numerous cases, both creating a charge over the book debts (receivable) and whether the charge is a fixed or a floating charge have been discussed for a long time[104]. The distinction between a fixed charge and a floating charge might be difficult, and it largely depends on the facts of cases. In cases wherein it is difficult to distinguish these charges, recharacterisation will be helpful. However, if a charge-back used to be recognised as a fixed charge but the charge-back is recharacterised as a floating charge, there might be registration and priority issues. Therefore, it is important to distinguish whether the charge-back is a fixed charge or a floating charge. However, it is not clear from the case law.

To solve the abovementioned questions, the nature of bank account will be a crucial factor. The next section discusses the nature of bank account.

3.2 The Nature of Bank Account

In England, there seems to be no clear definition of the nature of bank

102 Evans, 'Case Comment: Decision of the Court of Appeal in Morris v Agrichemicals Ltd: a flawed asset?' (n 101), at 104

103 Ibid at 104

104 *Re Brumark Investments Ltd* [2001] 2 A.C. 710 (PC); *Spectrum Plus Ltd* [2005] 2 A.C. 680 (HL); *Re Keenan Bros Ltd* [1986] 2 B.C.C. 98970 (SC)

account or cash balance[105]. Derham (2010)[106] explains that the credit balance in bank account is not a tangible property, that is in possession till the liabilities in question are satisfied, so that it is a debt[107]. There is no doubt that credit balance on bank account is a chose in action and a debt. However, these expressions may not clearly or adequately explain the nature of a cash balance in a bank account.

The first question is whether or not a credit balance is a property. This problem is directly related to the question of possibility of a charge-back. If the credit balance is considered a property owned by the customer, they can grant a charge on the credit balance in favour of the bank. However, if the credit balance is a property owned by the bank, the bank cannot grant a charge on the credit balance in favour of the bank[108], because common law does not allow a person to contract with oneself. Mujih (2001)[109] explains that some deny that cash balance is a property. Furthermore, even if the cash balance is considered a property, it is owned by the bank[110]. That is to say, if cash balance is not a property, the creation of a charge-back is not possible. Furthermore, if cash balance is a property owned by the bank, the creation of charge-back is still not possible. However, since the House of Lords accepts the creation and the validity of a charge back, an alternative explanation will be needed.

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105 In the US, Article 9 of the Uniform Commercial Code defines a deposit account. It defines deposit account as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance."

106 Rory Derham, *The Law of Set-off* (4th edn, Oxford University Press 2010)

107 Ibid at 782

108 Mujih (n16)

109 Ibid

110 Goode says that "we do indeed have a new and expanded concept of property" (see. Roy Goode, 'Charge-backs and legal fictions' (1998) 114 Law Quarterly Review 178 at179)

Lord Hoffmann in *Re BCCI SA* (no.8)[111] states that 'the depositor's right to claim payment of his deposit is a chose in action which the law has always recognised as property. There is no dispute that a charge over such a chose in action can validly be granted to a third party'[112]. His view seems to emphasise that the cash balance is a chose in action. Hence, it is better to perceive a chose in action rather than a property as the nature of cash balance.

Second, even though there is no doubt that the cash balance is the debt, the problem is whether the cash balance belongs to a book debt. In other words, whether or not the cash balance is included in a book debt seems to be a crucial problem. This issue is also related to the next section, registration.

In *Re Brightlife case*[113], Hoffmann J (at that time) states that 'I do not think that the bank balance falls within the term "book debts or other debts" as it is used in the debenture. It is true that the relationship between banker and customer is one of debtor and creditor. It would not therefore be legally inaccurate to describe a credit balance with a banker as a debt, but this is not a natural usage for a businessman or accountant. He would ordinarily describe it as "cash at bank"'[114]. That is to say, Hoffmann J seems to consider that the money deposited by a trader with his bank does not fall within the scope of a book debt[115]. Goode (2009)[116] points out that the view adopted by Hoffmann J was that a bank account, in an ordinary situation, is not a book debt[117].

111 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

112 Ibid at 226

113 *Re Brightlife Ltd* [1987] Ch. 200 (Ch. D)

114 Ibid at 208

115 After this case, in *Re Permanent Houses (holdings Ltd)* ([1989] 5 B.B.C. 151 (Ch. D)), Hoffmann J did not directly mention his opinion about whether cash balance is a book debt or not.

116 Goode, *Legal Problems of Credit and Security* (n 42)

117 Ibid at 109

In *Northern Bank Ltd case*[118], Hutton LJ considers three aspects, such as business practice, the earlier decision and the construction of the fixed charge, and clearly states that money in bank account is not 'book debts and other debts' as mentioned by Hoffmann in *Re Brightlife Ltd case*[119]. According to this decision, it can be considered that 'an obligation to resister is unlikely to arise in the case of bank deposit' [120].

3.3 Registration

As mentioned before, whether the cash balance in a bank account is a floating charge or charge over a book debt might change the result. Chapter I of Part 25 of the Companies Act 2006[121] gives a registration rule in England and Wales of charge granted by companies. Any floating charge is registrable, but not all charges are registrable. It is said that 'there are some notable omissions from the list, including fixed charges over contractual rights, if they are not book debts, securities, investment, and bank accounts' [122].

When the depositor is a company, it has to be determined whether a charge falls within the scope of a charge which is registrable under section 395 of the Companies Act 1985[123]. If the depositor fails to register as a charge to the Companies Registration Office (CRO) within 21 days of the creation of the charge, the charge will be void against the liquidator or any creditors of the depositor. Accordingly, it might be a crucial matter for the depositor (company)

118 *Northern Bank Ltd v Ross* [1991] BCLC 504 (CA)

119 *Re Brightlife Ltd* [1987] Ch. 200 (Ch. D) (n 113)

120 Derham (n106) at792

121 The Companies Act 2006 (2006 Chapter 6) ; before this, Chapter I of Part XII of the Companies Act 1985

122 McKnight (n 68) at1046

123 the Companies Act 1985 (n48)

whether or not it is a charge over the book debts.

owever, although a charge is registrable under section 395 of the Companies Act 1985, if the Financial Collateral Arrangements (No.2) Regulation 2003[124] applies to the case, it would not be registrable. Regulation 4 (4) stipulates that 'section 395 of the Companies Act 1985 (certain charges void if not registered) shall not apply (if it would otherwise do so) in relation to a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement'[125]. The term 'security financial collateral arrangement' is also defined in Regulation 3[126], according to which, the term financial collateral includes the cash.

In accordance with this regulation, if the financial collateral is in the possession or under the control of the collateral-taker, this regulation will apply to the charge of the cash balance in bank account granted in favour of the bank. Derham (2010)[127] states that 'if a company has the right to operate a bank account the subject of a charge-back without restriction until such as the bank

124 The Financial Collateral Arrangements (No.2) Regulation 2003 (2003 No.3226)

125 Ibid regulation 4

126 Regulation 3 stipulates that "security financial collateral arrangement" means an agreement or arrangement, evidenced in writing where-

(a) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral-taker;

(b) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations;

(c) the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf, any right of the collateral-provider to substitute equivalent financial collateral or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral-taker; and

(d) the collateral-provider and the collateral-taker are both non-natural persons;

127 Derham (n 106)

effects a set-off, a charge over the account would resemble a floating charge, in which case the agreement may be registrable on that ground' [128].

However, according to Roberts, although it is still open for banks to register the charges over credit balance and there are theoretical problems, the Companies Registration Office, in practice, tends to accept the application for the purpose of registration of the charges.

3.4 Mortgage-back?

Under English law, the validity of the mortgage-back is still unclear even after the decision of the House of Lords in *Re BCCI case*[129]. It can be imagined that the argument about charge-back discussed above will apply to the argument of mortgage-back in various aspects. However, the issue of the validity of the creation of security over indebtedness is likely to be more arguable in mortgage-back problem than in charge-back problem[130]. The most remarkable difference between a mortgage and a charge is assignment. A mortgage, indicating both equitable and legal mortgages, is created by way of the assignment of the secured property to the secured party.

First, a conflict might appear if a creditor assigns the debt to the debtor, because the debtor would become their own creditor. In this case, the interests will merge[131], and no debt or security will exist. It is said that '...merger in *Re BCCI* (*no.8*) in the context of an equitable charge, where he emphasized that in the case of a charge the depositor retains title, suggests that he may have

128 Derham (n 106) at 793

129 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

130 Derham (n 106) at 780

131 Ali points out that "two of reasons given for the conceptual impossibility of charge-backs in *Re Charge Card Service Ltd* relate to the merge of interests in the chose in action. (see Ali, (n 93))

regarded the question as open in relation to a mortgage'[132]. The House of Lords might consider that the merger is not a problem where an equitable charge is in issue.

Second, as mentioned above, the Financial Collateral Arrangement (No.2)[133] Regulation might impact the charge-back case. This might also cover mortgage-back. The term 'security interest' is also regulated and defined in regulation 3, and it includes a mortgage. Accordingly, the validity of mortgage-back seems to be assumed[134]. Regulation 17 deals with mortgage, and it stipulates that 'where a legal or equitable mortgage is the security interest created or arising under a security financial collateral arrangement on terms that include a power for the collateral-taker to appropriate the collateral, the collateral-taker may exercise that power in accordance with the terms of the security financial collateral arrangement, without any order for foreclose from the courts'[135]. Combined with the definition of security financial collateral arrangement, regulation 17 does not apply where collateral-taker or collateral provider is natural person.

3.5 Other Problem

3.5.1 Enforcement

Although a charge-back could be the same as the charge over other asset, there is one exception. McKnight (2008)[136] says that the manner of enforcement of the charge is the only different point between the charge over its own

132 Ali (n 93) at 781

133 The Financial Collateral Arrangements (No.2) Regulation 2003 (2003 No.3226) (n 124)

134 Ali (n 93) at 781

135 See Regulation 17

136 McKnight (n 68)

indebtedness and the charge over other types of property[137]. Lord Hoffmann states that 'The method by which the property would be realised would differ slightly: instead of the beneficiary of the charge having to claim payment from the debtor, the realisation would take the form of a book entry' [138]. That is to say, the way to enforce a charge over the indebtedness is book-entry. This is because the other methods of enforcement, such as the sale, cannot be exercised as it is a charge over cash balance, which is its own indebtedness.

However, the method of enforcement by way of book-entry is considered to be foreclosure. Ali (2002)[139] points out that 'foreclosure is, under English law, considered to be exclusive to mortgage' [140]. Furthermore, Goode (1998)[141] strongly criticises about this point by following that: 'the true position is that there is no mode of realisation of any kind whatsoever. None of the ordinary remedies available to a secured creditor are available to the bank in a charge-back transaction. ... it cannot invoke any form of judicial relief, nor does it have any of the normal extra-judicial remedies for enforcement of security' [142]. Further, he denies the way of enforcement such as sale, right to sue, appointment of receiver, collection by himself. The decision of the House of Lords accepted the way to enforcement as book-entry. However, in theory, since the bank is both debtor and creditor, any methods of enforcements and any remedies might be deniable.

3.5.2 Priority and Negative Pledge

As mentioned above, it is no doubt that the credit balance in a bank account

137 This could be also considered by the House of Lords in *Re BCCI* case (see. n 10).

138 ibid at 226-227

139 Ali (n 93)

140 Ibid at 279

141 Goode, 'Charge-backs and legal fictions' (n 110)

142 Ibid at 179

is a chose in action. In this case, the rule in *Dearle v Hall*[143] will apply to the priority of the charge over a credit balance. The rule is based upon the order in which the creditor gives the notice of charge or assignment to the debtor[144]. However in the case of a charge-back, since both the debtor and the charge tend to be the same, that is, the bank, it can be considered that the bank does not need to give constructive notice to itself. The reason is that it does not have to protect the priority. If a charge-back is considered to be a proprietary interest, it will fall within the scope of a negative pledge, which will prevent it from gaining any other secured loan without consent.

3.6 Summary

The nature of bank account is a crucial issue of charge-back. As discussed above, even if it is a property, the next problem is who owns it. If owned by the customer, there is no theoretical problem. However, if owned by the bank, this conflicts with the common law rule, that is to say, a person cannot contract with oneself. As for the nature of bank account, it is unclear from the recent decision in the House of Lords.

Furthermore, whether it is a fixed charge or a floating charge is also not clear. This issue is related to the nature of bank account. However, in the UK, there is no clear definition of bank account or cash balance. Whether or not the cash balance falls within the scope of a book debt has been discussed and remains unclear in case law.

The core issues mentioned above are expected to lead to other issues such as

143 *Dearle v Hall* [1828] 38 E.R. 475 (Ch.D)

144 It is said that it will be done "unless the chargee or assignee had actual or constructive notice of the charge-back at the time of its creation or his advance or other payment." (see Evans, 'Triple cocktail becomes single malt? Some thoughts on the practical consequences of the decision of the House of *Lords in Morris v Agrichemicals*' (n 101))

the registration, mortgage-back, enforcement, and priorities. Therefore, since these core issues are not resolved, other issues will not be solved as well.

Chapter IV　Triple Cocktail

4.1　Triple Cocktail

Triple cocktail is a single document containing charge-back, a right of set-off, and a flawed asset arrangement. The triple cocktail has a function of making up the other security's or quasi-security's failure. For example, if a charge-back fails, a right of set-off will work. Or, if a right of set-off fails, a flawed asset will work. Accordingly, triple cocktail is useful because it can fit various occasional situations.

According to Wood (2008)[145], triple cocktail used to be common in the 1990s, but it has become less common now[146]. As mentioned earlier, after the decision of *Re BCCI SA (no.8) case*[147] accepted the validity of a charge-back, a charge-back is an enough right to access the cash balance in a bank account. Therefore, the necessity of the triple cocktail seems to have faded.

However, even after the decision of *Re Charge Card case*[148], triple cocktail has still been used in a commercial transaction. Ali (2002)[149] argues that, after the *Re BCCI (no.8) case*[150], the number of its usage has hardly decreased. He identifies two reasons to utilise the triple cocktail. First, a flawed asset arrangement and a right of set-off grant 'insurance' when a fixed charge over a cash balance in

145　Wood, *Law and Practice of International Finance* (n 97)

146　Ibid at 223

147　*Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

148　*Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

149　Ali (n 93)

150　*Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

bank account is recharacterised as a floating charge[151]. Second, 'lawed assets and set-off rights are not subject to the moratorium imposed by the Insolvency Act 1986 on the enforcement of charges against the property of companies in administration' [152].

In England and other jurisdictions based on the UK law, a right of set-off can be exercised in very limited situation.[153] A charge-back and a flawed asset arrangement will play auxiliary roles just in case. Therefore, the triple cocktail is still likely to be common and demanded in commercial transactions. As a charge-back is discussed in previous chapters, this chapter discusses other two quasi-securities, that is, a right of set-off and a flawed asset arrangement.

4.2 Set-off

4.2.1 Introduction

According to the definition of McKnight (2008)[154], a set-off is 'the means by which opposing cross-claims between parties are applied or netted against each other to arrive at a net balance that is payable one way or the other' [155]. Set-off can be divided into two parts, pre-insolvency set-off and insolvency set-off[156]. As for this point, Wood (1989)[157] and Goode (2009)[158] consider that there are five types of set-off, such as independent set-off, transaction set-off, contractual set-

151 Ali (n 93) at 280

152 Ibid at 280

153 Philip Wood, *Comparative Law of Security Interests and Title Finance* (2nd edn, Sweet & Maxwell 2007); Philip Wood, *Set-off and Netting, Derivatives, Clearing Systems* (2nd edn, Sweet& Maxwell 2007)

154 McKnight (n68)

155 ibid at 845

156 Ibid at 845

157 Philip Wood, *English and International Set-off* (Sweet& Maxwell 1989)

158 Goode, *Goode on Legal Problems of Credit and Security* (n 42) at 277-278

off, current account set-off, and insolvency set-off. Although these types of set-off need different conditions to be operated, it is said that some conditions are considered to be more common. The conditions are as follows: (1) money claim and money cross-claim, (2) the existence of two distinct accounts, (3) mutuality (except for contractual set-off)[159].

Since set-off has numerous related cases and issues to discuss, it is impossible to explain all of them. Therefore, this article will only deal with the topic related to the charge-back and triple cocktail. This section discusses charge-back and set-off, especially contractual set-off and insolvency set-off, which are related to charge-back.

4.2.2 Contractual Set-off and Priority

Contractual set-off is used when the parties agree that the debtor may pay, discharge, reduce or extinguish the creditor's claim by the amount of the debtor's cross-claim and thereby pay them both' [160]. Compared to other types of set-off, it tends to be more flexible, since contractual set-off is an agreement between parties[161]. Wood (2007)[162] says that set-off uses the loan to knock out the deposit, like skittles' [163]. As this statement indicates, a right of set-off is effective as a security, however this is not right in rem but a personal right.

In *Re Charge Card Service*[164], Millett J states that 'Equity looks to the substance not to the form, and while in my judgment this would not create a

159 Goode, *Goode on Legal Problems of Credit and Security* (n 42) and McKnight (n 68)

160 Wood, *English and International Set-off* (n 157), at193

161 Mujih explains that "contractual set-off involves the depositor agreeing with the bank to give it express rights to apply the credit balances in discharge of the relevant liabilities being secured." (see. Mujih (n 16), at11)

162 Wood, *Set-off and Netting, Derivatives, Clearing Systems* (n 153)

163 Ibid at 11

164 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

mortgage or charge, it would no doubt give a right of set-off which would be effective against the creditor's liquidator or trustee in bankruptcy'[165]. This opinion is criticised, because a right of set-off is a personal right and weaker than a security interest[166]. According to *Re BCCI case*[167], *MS Fashion case*[168] and *British Eagle case*[169], if the depositor creates a charge over the cash balance in favour of third party to secure his liabilities, a right of set off cannot be exercised.

The set-off before the insolvency is governed by common law[170]. Apparently, the common law does not accept 'a contingent liability, an unmatured liability or a third party liability to be set-off against a cash balance'[171]. Moreover, common law accepts an implied term or agreement between parties[172]. However, the agreement between parties has to precisely decide which deposits or which liabilities are basis of the set-off. As mentioned above, the contractual set-off is more flexible than any other set-off, so that a well drafted document on set-off could be efficient.

Priorities will be the chief issue regarding the contractual set-off and a charge. As the bank has just an equitable interest over the cash balance, the bank's interest might be overridden by a legal interest over the cash balance[173]. The bank can receive a notice where an assignment of the benefit in the cash balance

165 Ibid at 177

166 Mujih (n 16) at 11

167 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

168 *MS Fashion Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425 (CA)

169 *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 W.L.R. 758 (HL) (n 50)

170 Graham Roberts (n 87); Wood, *English and International Set-off* (n 157); Goode, *Goode on Legal Problems of Credit and Securit* (n 42)

171 Roberts (n 87) at 258

172 Roberts (n 87) at 258

173 Mujih (n 16) at 12

is exercised or the garnishee order is issued by the court[174]. Therefore, if the bank receives a notice, it might not set off. Mujih (2001)[175] contends that if the cash balance is a trust fund, the notice will be important. In *Barclays Bank v. Quistclose Investment*[176], the bank might not exercise a right of set-off when the bank received the notice that the credit balance is trust money[177]. Accordingly, depending on the content of the notice, it will be a crucial factor regarding priorities, since the bank's right of set-off might be limited.

A contractual set-off is also limited by another reason. In *Halesowen case*[178] and *Re Charge Card case*[179], the statutory set-off provisions, section 323 of the Insolvency Act 1986[180] and Rule 4.90 of the Insolvency Rules 1986[181], must apply in insolvency and bankruptcy. This means 'any contractual set-off going further than the statutory provisions' [182] is inefficient.

Wood (1989)[183] considers whether or not contractual set-off can become a charge. Derham (2010)[184] also discusses the possibility of a set-off as a charge[185]. Graham points out that if it were a charge, the corporate customer would need

174 Graham points out that "this will prevent a set-off of contingent or subsequent liabilities when they mature or crystallise." (n 88) at 258

175 Mujih (n 16) at12

176 *Barclays Bank v. Quistclose Investment* [1970] A.C. 567 (HL)

177 After this case, in *Neste Oy v Lloyds Bank* ([1983] 2 Lloyd's Rep. 658), it held that there is exception. The bank can exercise the right of set-off to the fund money, when it "was at the time of doing so a bona fide purchaser for value without notice of the trust" (at 666-667)

178 *Halesowen Presswork & Assemblies Ltd v. National Westminster Bank Ltd* [1972] AC 785 (HL) (n 25)

179 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

180 the Insolvency Act 1986 (1986 Chapter 45)

181 the Insolvency Rules 1986 (1986 No.1925)

182 Mujih (n 16) at 13

183 Wood, *English and International Set-off* (n 157) at209

184 Derham (n106)

185 Derham (n106) at793-804

to register a charge under section 395 and 396 of the Companies Act 1985. Furthermore, if it fails to register within 21 days of creation, the charge would be void against a liquidator[186].

4.2.3 Insolvency Set-off and Charge: Mutuality

A charge-back depends on set-off for its validity as a security. It will 'automatically discharge the secured obligations... in the event that the depositor goes into liquidation or is adjudged bankrupt' [187]. Compared to this, the existence of a charge over the cash balance in bank account will destroy the insolvency set-off 'mutuality between that debt and the debt due from depositor to bank' [188].

In *Ms Fashions case*[189], it is argued whether or not the charge-back destroys the mutuality. If a charge is created, the depositor will lose his beneficial interest. Then, the depositor's right, which is the right to return its deposit, will become the bank's right. As a result, set-off is not available. Hoffmann J (at that time) states that 'the existence of the charge destroys mutuality: the bank's claim against the depositor is in its own right but the depositor's claim is subject to the equitable interest of the bank' [190]. However, in *Re BCCI (no.8)* [191], this stance was not overruled. Therefore, this issue is still open.

Calnan (1998)[192] contends that 'it is suggested that the existence of a charge

186 Graham Roberts (n 87) at 259

187 Evans, 'Triple cocktail becomes single malt? Some thoughts on the practical consequences of the decision of the House of Lords in Morris v Agrichemicals' (n 101) at 116

188 Ibid, at 116

189 *MS Fashion Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425 (CA) (n 168)

190 Ibid, at 916

191 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

192 Goode, 'Charge-backs and legal fictions' (n 110)

destroys mutuality (except to the extent of any equity of redemption) and therefore there should be no automatic set-off on the liquidation of the bank in such a case' [193]. Mokal (1998)[194] argues that 'what is lost is Director's ability to apply the deposit for any purpose other than to pay off the secured debt. And in *MS Fashions* of course, neither Director nor Company are asking for the deposit to be applied except for the discharge of the secured debt. ...the very purpose of securing the deposit was to ensure that Bank would not be left without payment. ... the existence of the charge-back being no hurdle at all' [195].

As Lord Hoffmann in *Re BCCI case*[196] did not overrule *MS Fashions case*[197], therefore, it is still unclear whether or not the existence of charge-back destroys the insolvency set-off mutuality.

4.3 Flawed Asset

4.3.1 Meaning of Flawed Asset Arrangement

A flawed asset arrangement is considered as one of the quasi-securities, also known as conditional debt[198] or contractual condition of repayment[199], because it is a debt which is not payable unless certain events have occurred[200]. In this

193 Ibid at 175

194 Mokal (n 12)

195 Ibid at 108

196 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

197 *MS Fashion Ltd v Bank of Credit and Commerce International* SA [1993] Ch 425 (CA) (n 168)

198 Wood, *Law and Practice of International Finance* (n 97)

199 According to Goode, it is called contractual condition of repayment, which is an agreement that a bank does not have a right over deposit but just has a right of withholding repayment. (see. Goode, *Goode on Legal Problems of Credit and Security* (n 42))

200 Wood, *Law and Practice of International Finance* (n 97)

arrangement, a customer is restricted the ability of withdrawing funds from their bank account until their liability to the bank or certain conditions have been satisfied[201]. A flawed asset arrangement is commonly used in cash on deposit with a bank[202].

According to Graham Roberts (2009)[203], a flawed asset arrangement is effective when the right of set-off of a deposit cannot be exercised and a charge is not effectively created. Wood (2007 and 2008)[204] also states that a flawed asset arrangement can be useful when insolvency set-off is unavailable or in the situation when exercising a right of insolvency set-off is doubtful in a jurisdiction which does not accept the insolvency set-off[205]. Accordingly, a flawed asset arrangement plays the role of a backstop. In other words, a flawed asset arrangement is considered to be an alternative method to charge-back and set-off agreement[206].

Furthermore, if a party makes a combination contract of a charge-back and a flawed asset arrangement but fails to register a charge, the charge-back will be void against a liquidator but the flawed asset arrangement is still valid. Thus, under this situation, the arrangement is not affected by the failure of registration because the arrangement is just a contractual restriction of the right of repayment[207].

Evidently, a flawed asset has a similar effect to set-off and close-out netting[208].

201 Roberts (n87) at260-261

202 Ali (n 93)

203 Roberts (n 87)

204 Wood, *Comparative Law of Security Interests and Title Finance* (n 158), at 587; Wood, Law and Practice of International Finance (n 97), at 222

205 Wood, *Comparative Law of Security Interests and Title Finance* (n 158), at 587; Wood, Law and Practice of International Finance (n 97), at 222

206 Derham (n 106)

207 Derham (n 106) at 805

208 Loxton (n 2) at473

Loxton (2011)[209] states that the arrangement has similar effect as a charge-back and a contractual set-off. However, theoretically, they are completely different[210]. Furthermore, it is argued that the transactions are practically the same kind of set-off, because the debtor is not required to pay the creditor until the third party pays the debtor[211].

McKnight (2008)[212] and Goode (2009)[213] assert that a flawed asset arrangement is a contractual agreement between a bank and a customer. In other words, since the arrangement is just a conditional debt, it can be a pure contractual agreement[214]. Consequently, it cannot provide any proprietary interests with the bank. That is, it is not a charge and, of course, it is not regarded to be registered[215]. Furthermore, Graham Roberts (2009)[216] explains that a flawed asset arrangement is "a part of the contract of the deposit" [217]. He mentions the features of a flawed asset arrangement are not only a contractual agreement, but also 'conditional, or contingent' [218], because the debt is still contingent until the obligation to bank under this arrangement is not satisfied. Thus, the features of the arrangement are considered to be 'contractual agreement' between the customer and the bank and it is a contingent debt.

Based on the discussion above, the distinction between set-off, charge-back and the flawed asset arrangement can be considered. First, as mentioned in

209 Ibid

210 Ibid, at473-477

211 See. Wood, *Comparative Law of Security Interests and Title Finance* (n 158)

212 McKnight (n 68)

213 Goode, *Goode on Legal Problems of Credit and Security* (n 42)

214 The Court of Appeal approved that this kind of provision was a purely contractual argument. (see. McKnight (n 68))

215 Derham (n 106)

216 Roberts (n 87)

217 Ibid

218 Derham (n 106) at 805

chapter III, a charge-back has a proprietary interest[219] and needs to be registered. However, a flawed asset is just a contractual right, so that there is no need for registration and no exclusive right to access the cash balance in bank account. Second, a right of set-off is a right to exercise it. However, a flawed asset is a kind of a right of reservation.

Calnan (2011)[220] points out the efficacy of a flawed asset arrangement in practice, stressing that if it works in theory, it will effectively work . If the wording of this arrangement is clear enough, it will work; if not, it may be a source of further conflict. For example, if the wording of the agreement does not indicate what exactly the liability is, it should be difficult for a court to judge whether or not the liability is fully paid or satisfied. Accordingly, wording of the agreement is important to determine the real intention of the parties. Furthermore, Calnan (2011)[221] also states that a flawed asset arrangement used to be common but has become less important now. It is because there was a doubt about taking security over the customer's deposit and some deficiencies in the law of insolvency set-off rules. As stated in previous chapters, most of these problems are said to be resolved in case law and some regulations[222]. Hence, he considers it is less important under this situation.

However, the triple cocktail is actually still effective and is utilised among practitioners and in ordinary transactions. It can be considered that the arrangement still plays a role of an alternative to charge-back and set-off in the case of failure of registration of charge-back or unavailability of set-off. The sections ahead focus on the process that a flawed asset has been recognised by

219 As discussed in chapter III, this point is still arguable. However, this article will follow the view of Lord Hoffmann in *Re BCCI case* (*see. Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10))

220 Richard Calnan, *Taking Security: Law and Practice* (2nd edn, Jordan Pub. 2011)

221 Ibid

222 It is mentioned in the previous chapter.

the courts and the weak point of a flawed asset.

4.3.2 Case Law

It is said that the concept or the term of flawed asset has appeared in recent years. According to Loxton (2011)[223], this term first appeared in an article in 1981[224]. A flawed asset is not a proper legal term. In England, the concept or the word was recognised in the Court of Appeal of *Re BCCI (no.8) case*[225], though practitioners had been using this word before this case[226]. McKnight (2008)[227] points out that the arrangement could be developed from the decision of *Re Charge Card case*[228]. Since *Re Charge Card case* produced the difficulty of charge-back, the arrangement was created to overcome the difficulty[229].

In *Re BCCI (no.8) case*[230], the depositor promised a letter to give a lien or charge over the deposit, and agreed that the deposit would not be payable until the liabilities of the borrower are repaid. The Court of Appeal of this case approved the concept of a flawed asset agreement, and mentioned that the bank could take effective security in other ways. Moreover, in the decision of the House of Lords, Lord Hoffmann accepted the view of the Court of Appeal and did not add any new comment about the arrangement. Accordingly, the view of the Court of Appeal and House of Lords is probably the same.

The main issue of this case was whether or not it was possible or effective to

223 Loxton (n 2)

224 Ibid, at 477

225 *Re Bank of Credit and Commerce International S.A. Ltd.* [1996] 2 ALL ER 121 (CA) (n 9)

226 Loxton (n 2)

227 McKnight (n 68)

228 *Re Charge Card Services Ltd* [1987] Ch. 150 (n3)

229 McKnight (n 68)

230 *Re Bank of Credit and Commerce International S.A. Ltd.* [1996] 2 ALL ER 121 (CA) (n 9)

take a charge over the deposit. Lord Hoffmann also mentioned about a flawed asset in his opinion. He said, 'But they said that it could provide perfectly good security by virtue of contractual provisions in the third paragraph which limited the right to repayment of the deposit and made it what is sometimes called a "flawed asset". I agree' [231]. Furthermore, Lord Hoffmann stated later that 'If the deposit was made by a third party, it could enter into contractual arrangements such as the limitation on the right to withdraw the deposit in this case, thereby making the deposit a "flawed asset". All this is true' [232]. Their Lordships were of the same opinion. However, Lord Hoffmann did not seem to recommend choosing the way of a flawed asset arrangement, because he affirmed that taking security over the deposit was available.

To sum up, the concept of a flawed asset arrangement is approved by the Court of Appeal and the House of Lords. In addition, since the House of Lords, especially Lord Hoffmann, did not put any additional comment about this, the view of the Court of Appeal could be purely affirmed by the House of Lords. After this decision, there is no case about a flawed assets arrangement as a part of triple cocktail[233]. As for the importance of a flawed asset arrangement, as Lord Hoffmann said that the charge over the deposit could be taken, the flawed asset could be less important.

4.3.3 A flawed Asset and Insolvency

There is a concern about a flawed asset arrangement, because it is possible that the arrangement conflicts with the pari passu rule in insolvency[234]. Pari passu

231 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10), at 225

232 Ibid, at 227

233 The very recent case that the Supreme Court mentioned about a flawed asset agreement could be *Belmont Park case* [2011] UKSC 38 (27 July 2011).

234 Ali (n 93)

is a rule which mandates to deal with the same category of creditors equally in the event of insolvency. According to *British Eagle International Airline Ltd v Compagnie Nationale Air France*[235], any arrangement or agreement, which contravenes statutory pari passu rule, will be void. From wide interpretation of this decision, a flawed asset arrangement seems to be void.

However, as mentioned and emphasised above, the Court of Appeal[236] and the House of Lords[237] have already affirmed the validity of a flawed asset arrangement. "' the debt forms part of the pool of assets available for distribution to the insolvent's creditors (with such distribution being subject to the pari passu rule), the debtor is entitled to withhold payment until the conditions for payment have been met' [238]. That is to say, it might not be an unequal treatment to withhold the repayment. Roberts (2009)[239] also contends that 'There must be some concern that the flawed asset agreement would not survive an insolvency of the customer, due to the pari pasu principle enacted in section 107 of the Insolvency Act 1986' [240]. Thus, this flawed asset arrangement will not survive on the insolvency even though it seems to breach pari passu rule.

Chapter V Conclusion

The debate on whether creating a charge over one's own indebtedness has

235 *British Eagle International Airlines Ltd v. Compagnie Nationale Aile France* [1975] 2 ALL E.R. 390 (HL) (n 50)

236 *Re Bank of Credit and Commerce International S.A. Ltd.* [1996] 2 ALL ER 121 (CA) (n 9)

237 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

238 Ali (n 93) at187

239 Roberts (n 87)

240 Roberts (n 87) at 261

been resolved by Lord Hoffmann's opinion in *Re BCCI case*[241]. His opinion is considered to be the final word. However, as mentioned in the previous chapters, there are some unresolved issues.

First, the issue concerned with the coherence of case law is discussed in Chapter II. There are two streams of case law regarding creating a security over one's own indebtedness. In *Halesowen Preswork & Assemblies Ltd v National Westminster Bank Ltd*[242], Buckley LJ states that no one can have a lien over his or her property. Lord Hoffmann claims that a lien and a charge are different securities. Therefore, he did not overrule this case. This leads to the next chapter's problems. Therefore, some scholars argue that he had to overcome the rule of *the Halesowen case*[243].

Second, in chapter III, the issues regarding charge-back are discussed. The core issues are divided into two: first is what is the nature of charge-back; Second is what is the bank account, in other words what is the cash balance. The first and second issues are related to each other. Moreover, both are not clear from case law.

The first issue is whether a charge-back has same features as a charge. Lord Hoffmann says that a charge-back is a proprietary security interest. However, some scholars argue that a charge-back is contractual security not a proprietary security interest, because it is not categorised in the scope of section 395 of the Companies Act[244]. In addition, whether a charge-back is a fixed charge or a floating charge is also an arguable topic. This question is related to the next issue.

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241 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

242 *Halesowen Press work & Assemblies Ltd. v National Westminster Bank Ltd* [1971] 1 QB 1 (CA), at 46 (n 5)

243 Ibid

244 The Companies Act 1985 (1985 Chapter 6); Whether or not a charge- back is categorised in the scope of section 395 of the Companies Act 1985 is also arguable.

The second issue is the nature of a bank account. It is said that a bank account is a property. If so, the next problem is who owns it. If it is owned by the bank, this conflicts with the common law rule, that is to say, a man cannot contract with himself. Therefore, some scholars claim that a bank account is not a property. Furthermore, whether or not a bank account is book debts is also an issue, despite being discussed for a long time. The core issues mentioned above are related to other issues such as the registration, mortgage-back, enforcement, and priorities. It can be said that the opinion of Lord Hoffmann is not enough to explain these issues.

Third, Chapter IV discusses the roles of the triple cocktail, which includes a charge-back, a set-off and a flawed asset arrangement. As a charge-back has been discussed in the previous chapters, the issues about a set-off and a flawed asset arrangement are examined in this chapter.

As for triple cocktail, it has been considered to become uncommon after the decision of House of Lords in *Re BCCI case*[245]. Nevertheless, triple cocktail remains effective as both set-off and a flawed asset arrangement act as security when a charge-back fails. Further, two types of set-off, that is, a contractual set-off and an insolvency set-off are closely related to charge-back. First, in a contractual set-off, the priorities and the notice will be issues, because if the bank receives the notice, the bank might not exercise the right of set-off. Especially, in case the bank receives a notice stating that the credit balance is trust money, the bank cannot exercise the right of set-off. Second, the insolvency set-off has an issue about the mutuality. The existence of a charge-back may destroy the insolvency set-off mutuality, because if a charge is created, the depositor loses his beneficial interest and the right becomes the bank's right. With respect to a flawed asset arrangement, the problem is whether or not the arrangement

245 *Re Bank of Credit and Commerce International S.A. Ltd.* [1998] AC 214 (HL) (n 10)

conflict with pari passu rule. This issue is not clear from the case law. Therefore, a set-off and a flawed asset arrangement have weak points respectively. Therefore, triple cocktail might be still common among practitioners.

Thus, although it has been considered that the opinion of Lord Hoffmann has resolved the dispute, in reality, his opinion leads to some new issues regarding a charge-back. It is one of the reasons for the House of Lords not overcoming the previous case, which was against a charge-back. In addition, the core issues such as the nature of a charge-back and the nature of the bank account are crucial issues. Nevertheless, the reasoning about these issues seems to be weak. The unclear definitions of these natures lead to other issues. Resolving these issues will lead to resolving other related issues as well.

While the view of Lord Hoffmann is accepted by practitioners, but since the issue that whether a charge-back is a fixed charge or a floating charge is related to the registration, the practitioners still carefully deal with the charge-back and its registration. It can be said that these issues are not only theoretical but also a practical problem. To solve these issues, further courts decisions concerned with a charge-back will be expected.