



Précis Paper

Equitable Charges and the Law of Priorities

An interesting discussion about the priorities of competing charges and the consequences of unreasonable legal costs.

Discussion Includes

- Background and material facts
- Equitable charges
- The law of priorities
- Going behind a judgment debt
- Unreasonable legal costs
- Lessons for practitioners

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Equitable Charges and the Law of Priorities

1. In this edition of BenchTV, Laura Keily (Barrister, Ninian Stephen Chambers, Melbourne) and Christopher J. Bevan (Barrister, Eight Wentworth Chambers, Sydney) discuss the recent decision of the Victorian Supreme Court in *Morris Finance Pty Ltd v Commonwealth Bank of Australia* [2017] VSC 260.

Background and Material Facts

2. Ms Alameddine was the registered proprietor of a property. On 28 August 2015, she became bankrupt. Around 6 July 2015, the Commonwealth Bank (who had a registered mortgage over the property) sold the property as mortgagee in possession. After payment of its mortgage debt and costs, the Commonwealth Bank paid \$367,892.80 into Court, which was held in a fund.
3. Prior to becoming bankrupt, Mrs Alameddine had given guarantees under two lease agreements in relation to trucks, one with Morris Finance and another with GoGetta, the fourth defendant. This case involved the competing priorities of the owners of the trucks to the money that was held in the Court's fund. Morris Finance had lodged a caveat over the property in respect of its charge on 18 April 2013. GoGetta had also lodged a caveat, but later in time, on 15 May 2013.
4. A third party, Mr Uyanik, had also lodged a caveat over the property, claiming that he had a deed of charge over the property in question. In fact, it transpired that he had a deed of charge over a different property and this claim was dismissed.
5. The case highlights important equitable principles as well as the dangers of wasted costs.

Equitable Charges and Priorities

6. An equitable charge is a charge in writing whereby a particular asset is given to the satisfaction of a particular debt. In this case, the charging clauses in the contracts with Morris Finance and GoGetta charged the asset (the property) to the payment of debts. The key question that arose for determination was what was the law of priorities with respect to the two equitable charges, and whether the law was simply a question of priority in time.
7. The general equitable principle with respect to priorities of interest is that first in time to register a caveat has priority, all other things being equal. However, in this case, GoGetta

argued that all other things were *not* equal, and therefore that its charge should have priority.

8. "All other things being equal" invokes concepts such as disentitling conduct and clean hands. Ms Keily commented that it should also encapsulate scenarios where documents are not what they should be, including where a guarantee was not properly drawn up or a penalty was imposed.
9. GoGetta's argument was therefore founded upon the premise that they had a judgment debt, whereas Morris Finance did not, and there was insufficient evidence to support Morris Finance's claim. GoGetta sought to attack the underlying debt in a number of ways, including by arguing that there had been no evidence given of the debt, as the terms of the debt were not reflected in the payment schedule produced. Second, they submitted that as the stamp duty had not been paid, it was not fair for Morris Finance to claim priority in time when the various stamp duty requirements had not been complied with. Third, GoGetta argued that in circumstances where Morris Finance was charging an interest rate of 40 percent, what was a \$70,000 debt became \$150,000 quickly, and this was effectively a penalty.
10. In addition, GoGetta argued that Morris Finance had not complied with court orders and therefore had come to the court with unclean hands, thus precluding it from obtaining equitable remedies. The primary reason rationale for this argument was that the number of times that GoGetta had been required to come to court was unnecessary, and Morris Finance had accumulated unreasonable legal costs that were eating into the fund.
11. In the end, Morris Finance gave evidence that there was a judgment debt, thus negating many of GoGetta's arguments. However this evidence came very late in the proceedings. Once this evidence was revealed, Derham AsJ applied the rule that the first in time prevails, and found that Morris Finance's charge had priority. The judge found that where there were two judgment debts, it was inappropriate to go behind the judgment debt and inquire into the adequacy of the contract that supports the judgment, stating (at [47]):

Although there may be no res judicata or issue estoppel as between Morris and GoGetta (so that there is no merger of the causes of action under the Morris Lease or the GoGetta rental agreement in the respective judgments obtained) nevertheless, the claims put by each claimant plainly now turn on their judgments and not proof of the indebtedness arising under the underlying agreements, the Morris Lease and the GoGetta rental agreement. It is not appropriate to go behind the judgments in either case.

12. The case reminds practitioners that if they are running a case of this nature, it is important to obtain the judgment debt first before seeking to sue on it. A judgment debt protects a creditor from having a charge attacked on the basis of its execution or drafting.

Unreasonable Legal Costs

13. One argument as to why Morris Finance came to the court with unclean hands was its conduct in accumulating unreasonable legal costs, which took priority over GoGetta's claim and depleted the fund. This argument was not upheld, however Derham AsJ did disallow 25 percent of Morris Finance's professional costs, finding that these costs ought not to have been incurred.
14. Ms Keily noted that it was unclear whether the judge, when disallowing these costs, was applying the general principles of equity as part of the priority principle or exercising the court's inherent jurisdiction as to costs. Mr Bevan suggested that in future cases, an additional argument could be made that what is first in time – and what prevails – is limited to what was within the reasonable contemplation of the parties when they executed the equipment finance contracts and the charge, similar to the contractual principles set out in cases such as *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337. In those circumstances, it would not be reasonable to assume that the parties would have contemplated that unreasonable costs would have been caught by the charge. However, Ms Keily reminded viewers that this argument is limited to the terms of the clause, and in this case, Morris Finance's charge was broadly drafted and very generous to Morris Finance.

Lessons for Practitioners

15. Ms Keily and Ms Bevan considered that practitioners can learn a number of important lessons from this decision. First, ensure that your client obtains a judgment prior to starting to enforce an equitable interest in property, as the courts will not look behind a judgment debt. Second, if there are competing equitable interests, a party must accept that first in time prevails and give precedence to any earlier equitable interest. Finally, a later in time creditor may have a case to argue where the subject matter of the prior creditor's claim is unreasonable costs.

BIOGRAPHY

Laura Keily

Barrister, Ninian Stephen Chambers, Melbourne

Laura Keily is an expert in commercial litigation, competition and corporations law. With over a decade of experience, Laura has been involved in a vast variety of matters such as takeovers, schemes of arrangement and cross-border acquisitions. Laura is frequently called upon to represent directors and the government in cases involving corporate law, companies, and regulatory dealings with ASIC. Laura is also a member of the Law Council of Australia's Corporations Committee, and regularly participates in law reform. Most notably she was involved in the Council's submission on the 'Review of Insolvency and Bankruptcy laws'.

Christopher J. Bevan

Barrister, Eight Wentworth Chambers, Sydney

Christopher Bevan was admitted as a solicitor in 1980 and later called to the NSW Bar in 1991. Throughout his career Mr Bevan has developed a wide variety of practice areas including commercial, public/ administrative, appellate, equity, tax/ revenue and international law. Mr Bevan has an LLB, a BEc, and an LLM (Hons) from the University of Sydney.

BIBLIOGRAPHY

Focus Case

Morris Finance Pty Ltd v Commonwealth Bank of Australia [2017] VSC 260

Benchmark Link

https://benchmarkinc.com.au/benchmark/banking/benchmark_22-05-2017_banking.pdf

Judgment Link

<http://www.austlii.edu.au/au/cases/vic/VSC/2017/260.html>

Cases

Codelfa Construction Pty Ltd v State Rail Authority (NSW) (1982) 149 CLR 337