Privy Council Appeal No. 34 of 1995

(1) Tam Wing Chuen and
(2) Skai Import-Export Limited *Appellants*

v.

Bank of Credit & Commerce Hong Kong Limited (in liquidation) *Respondent*

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, Delivered the 26th March 1996

Present at the hearing:-

Lord Keith of Kinkel
Lord Browne-Wilkinson
Lord Mustill
Lord Steyn
Sir Michael Kerr

*[Delivered by **Lord Mustill**]*

This dispute requires the court to apply a familiar banking transaction in circumstances which were not familiar when it was devised. The familiar aspect was that the transaction took the shape of what is called a chargeback. Its essence is that a bank or other lender is encouraged to make an advance to a borrower by an arrangement whereby another person deposits money with the bank on terms that the deposit will stand as security for the repayment of the advance. The obvious purpose of the arrangement is to protect the lender against the risk that the borrower will become insolvent. The aspect which was not familiar when the transaction was entered into is that the insolvent party is not the borrower but the bank.

In the present case the lender (hereinafter "the Bank") was Bank of Credit & Commerce Hong Kong Limited, the Hong Kong affiliate of bankers whose failure has led to much litigation, but which in June 1990 must have appeared sound. The borrower was

Skai Import-Export Limited (hereinafter "the Company") to which the Bank extended credit facilities against foreign currency deposits made during June and July 1990 with the Bank by Mr. Tam Wing Chuen ("the Depositor"), a director and shareholder of the Company. By 17th July 1991 the Company had drawn down some HK$22m against the facility. On that date a petition to wind up the Bank was presented, and subsequently a provisional Liquidator and Special Managers were appointed. By then the value in local currency of the amounts deposited was some HK$30m.

The present dispute concerns the treatment in the winding-up of the credit balances constituted by the deposits, in the triangular relationships between the Company, the Depositor and the Bank. According to the Depositor, who has commenced proceedings in the Supreme Court of Hong Kong for declaratory relief, a mandatory set-off in liquidation - under section 264 of the Companies Ordinance (Cap. 32), read with section 35 of the Bankruptcy Ordinance (Cap. 6) - should be made between the amount of the deposits and a sum equal to the outstanding indebtedness of the Company, on the hypothesis that the transaction involved the assumption by the Depositor of a personal liability equal to whatever might be the indebtedness of the Company at any given time. On this view, the set-off would amount to a realisation of the security for the advances to the Company, and the Liquidator would have no claim against the Company for the amounts outstanding. By contrast the Bank maintains that there can be no set-off as between itself and the Depositor, since the latter assumed no personal liability under the financing arrangements, but merely put up the deposits as security. Thus, the bank would be at liberty to look first to the Company for the whole amount of its indebtedness and, although naturally obliged in principle to repay the deposits, would in practice be liable for no more than a dividend in the winding-up.

The unusual feature of the situation, that it is the lender not the borrower who has become insolvent, means that the Bank will be better off if the Depositor has no personal liability available for a set-off. This accounts for the paradox present in the argument throughout, that a lender who would ordinarily have been at pains to multiply the sources of reimbursement is strenuously disclaiming any personal claim against the Depositor. At first instance Barnett J. accepted the Bank's submission, but on the narrow ground that under these particular financing documents, although the Depositor incurred a personal liability, it was no more than contingent and had not matured at the date of the winding-up, so that it could not be the subject of a compulsory set-off. This proposition need not be considered further, since the Bank did not seek to uphold it in the Court of Appeal, where the

Bank prevailed again but on a different ground, that the documents did not impose any personal liability on the Depositor. The Depositor now appeals to the Board, arguing for his own personal liability to the Bank.

One point must be made at the outset. Ever since the judgment of Millett J. in *re Charge Card Services* [1987] Ch. 150 there has been a lively controversy about the juristic status of a chargeback arrangement. It was there suggested that, although where a debt is owed by B to A it can be made the subject of an equitable assignment in favour of C, this cannot be done where A is both creditor and chargor, and B is both debtor and chargee: for the debt is a chose in action, creating a right to sue, and whereas the right can be assigned to C it cannot be assigned to B, for he cannot sue himself. Thus, so it is maintained, a chargeback transaction cannot create a proprietary interest, and unless it is to be treated as entirely ineffective there is no choice but to regard it as giving rise to a personal liability on the part of the depositor, which will found a compulsory set-off in the event of insolvency. Various opinions have been expressed on the reasoning of Millett J. In some quarters it is disputed that a chargeback is ineffectual to create a proprietary interest. Taking a different line, the Court of Appeal in England, in *Morris v. Agrichemicals* (CA: 20th December 1995), whilst agreeing with that learned judge about the inefficacy of the so-called charge, disagreed with his conclusion, and held that no implication could be made about personal recourse against the Depositor by way of collateral security.

This brief account of the conflicting views will show that if the present action had been brought in England questions of general importance would have arisen, calling for close analysis. In Hong Kong however the position is different, for the transaction falls retrospectively within the scope of section 15A of the Law Amendment and Reform (Consolidation) Ordinance:-

> "For the avoidance of doubt, it is hereby declared that a person ('the first person') is able to create, and has always been able to create, in favour of another person ('the second person') a legal or equitable charge or mortgage over all or any of the first person's interest in a chose in action enforceable by the first person against the second person, and any charge or mortgage so created shall operate neither to merge the interest thereby created with, nor to extinguish or release, that chose in action."

Thus, there is no reason to start with the premise that the Depositor has been unsuccessful in creating a security over the deposit in favour of the Bank, and to reason from this that the intention and effect must have been to create a personal liability;

thus opening the way to a set-off which may be exercised in favour of, or more unusually against, the Bank in the event of a liquidation. The only question is whether such a liability is created by the words of the documents themselves.

When considering this short question of construction the task is not advanced by recourse to a supposed general presumption of law against the assumption of personal liability. Their Lordships cannot read *re Conley* [1938] 2 All E.R. 127 as establishing any such proposition. That was a case where, in a triangular situation such as the present, the equivalent of the Company had with dishonest intent paid off its overdraft with the bank, so as to procure the release of the deposit to the depositor, so as to take the deposit away from the general creditors. The question was whether the person equivalent to the Depositor in the present case was a "surety or guarantor" within section 44 of the Bankruptcy Act 1914. It was argued that she did not qualify, since the bare fact of the deposit did not create a personal liability; and without such a liability she could not be a surety. The general importance of the case rested in the rejection by the Court of Appeal of the second proposition. This has no bearing on the present case, and in their Lordships' opinion the treatment of the first question yields nothing which can be applied uncritically in every situation. They find it much safer to proceed without recourse to doctrine, by taking notice of the fact of life that in a triangular situation if A contracts with B on terms which explicitly make B liable, and contracts with C on terms which do not explicitly make him liable, or liable only on a small scale, it is up to A in the normal situation (where he wants C to be personally liable) to explain why he has not said so. So also, in the very unusual case where it is C who wishes it to be held that he is personally liable, he must give a convincing account of why he did not write down what he intended.

Nor are their Lordships much helped by a division of the enquiry into express and implied undertakings of liability. It is true that if the documents creating the transaction state in so many words that a party is to be personally liable there will usually be no need to look further. But even in the absence of such a provision, it may be that the assumption of liability is plain from the other provisions of the agreement, or its general shape or its commercial context and purpose, or from a combination of all of them. In such a case the party will be held liable, not through the implication of a term, but simply because that is what the contract, properly understood, actually says.

The question therefore is whether this contract read as whole says that the Depositor is to be personally liable, and if so for what. The Depositor answers in the affirmative, and in particular

asserts that the liability is co-extensive with the amount of the deposit. The Bank denies this, in the general and the particular. The issue thus raised is very short, but cannot fairly be addressed without setting out large parts of the contractual documents.

> "1.01 In consideration of your granting or continuing to make available credit facilities or other financial accommodation, at the request of the undersigned, Mr. Tam Wing Chuen of HKIC#E607027(6) ('the Depositor'), for so long as you may think fit to SKAI IMPORT-EXPORT LIMITED of RM.2003A Nan Fung Centre, 264-298 Castle Peak Road, Tsuen Wan, N.T. ('the Customer'), the Depositor has deposited with you the sum of AUD FIVE HUNDRED NINETEEN THOUSAND SIX HUNDRED TWENTY FIVE & CENTS SIXTY ONE ONLY AND CAD TWO MILLION THREE HUNDRED THIRTY ONE THOUSAND ONE HUNDRED FIFTY EIGHT & CENTS SEVENTY SIX ONLY ('the Deposit' which expression shall include any currency into which such sum may from time to time be converted, any renewal of such sum on deposit and any interest and/or other moneys charged under this Clause) which is presently represented or evidenced by the instrument(s), brief particulars of which are set out in the Annexure hereto (it being understood and agreed that the Deposit may from time to time hereafter be represented or evidenced by other instruments of different dates and numbers) free from any lien, charge or encumbrance of any kind, and, as beneficial owner, hereby charges to you, by way of first fixed charge, all the right, title and interest of the Depositor whatsoever, present and future, in and to the Deposit [interest on the Deposit]*[and all other moneys from time to time standing to the credit of any account(s) of the Depositor with you]*, together with any certificate(s) or other instrument(s) relating thereto, as a continuing security for the punctual payment to you on the respective due dates of all moneys which are now or may at any time hereafter be or become from time to time due or owing to you by the Customer anywhere, or in respect of which the Customer may be or become liable to you, whether on any current, deposit, loan or other account or otherwise in any manner whatsoever (in all cases where alone or jointly with any other person, and in whatever style, name or form, and whether as principal or surety), in each case at the time, in the place and in the manner required of the Customer, and including (without limitation) the amount of any loans, acceptances or other credits or advances made to the Customer or others, for the accommodation or at the request of the Customer, and of any notes or bills, made, accepted, endorsed, discounted

or paid, and of any liability under guarantees, indemnities, foreign exchange contracts (spot and forward), documentary or other credits or any instruments whatsoever, from time to time assumed or given or entered into by you for or at the request of the Customer, together with interest to date of payment at such rates and upon such terms as may from time to time be payable by the Customer (or which would have been so payable but for the death, bankruptcy, liquidation, winding-up or other incapacity of the Customer), commissions, discounts, fees and other charges, all disbursements and all expenses incurred by you in relation to the Deposit, or the preparation or enforcement hereof or any guarantees or securities for any moneys, obligations or liabilities hereby secured, including all legal costs and all other costs and expenses and any exchange control premiums, penalties or expenditure on a full indemnity basis.

...

2. The Depositor, as beneficial owner, hereby charges by way of fixed first charge to you all the Deposit and all right, title and interest of the Depositor whatsoever, present and future, thereto and therein, together with any certificate(s) or other instrument(s) relating thereto, as a continuing security for the payment and settlement of the moneys and liabilities referred to in Clause 1.01 or otherwise hereby secured.

3.01 If the Customer has failed to pay any moneys hereby secured when due or if the Depositor is in default under any of the terms hereof or if the Customer or the Depositor is unable or admits inability to pay debts as they become due or in the event of any proceedings in or analogous to the bankruptcy, insolvency, winding-up or liquidation or composition of the Customer or of the Depositor or if legal process is levied or enforced against any assets of the Customer or the Depositor, you may, without demand, notice, legal process or any other action with respect to the Depositor, retain, apply or realise the Deposit or any part thereof, for your own benefit, at any time and in any way which you may deem expedient, free from and discharged from all trusts, claims, rights of redemption and equities of the Depositor in or towards payment and settlement of the moneys and liabilities referred to in Clause 1.01.

...

4. The Depositor hereby represents and warrants that during the continuance of this security:-

(i) the Depositor has and will maintain unencumbered and absolute title to the Deposit (except as provided herein); and

(ii) this instrument constitutes and will continue to constitute the valid and legally binding obligations of the Depositor, enforceable in accordance with its terms.

5. The Depositor hereby undertakes and agrees that during the continuance of this security, the Depositor shall:-

(i) not withdraw the Deposit and shall not mortgage, charge, pledge or otherwise encumber or assign, transfer or otherwise deal with or grant or suffer to arise any third party rights over or against the whole or any part of the Deposit or purport so to do, expect in your favour; ...

6.01 The Depositor hereby agrees that you may, at any time without notice, notwithstanding any settlement of account or other matter whatsoever, combine or consolidate all or any of the Depositor's then existing accounts (of any nature or description whatsoever and whether subject to notice or not) including the Deposit and set-off or transfer any sum standing to the credit thereof in or towards satisfaction of any liabilities of the Depositor referred to in Clause 1.01 or otherwise hereby secured, whether such liabilities be present or future, actual or contingent, primary or collateral, and several or joint and where such combination, set-off or transfer requires the conversion of one currency into another, such conversion shall be calculated at your spot buying rate of exchange (as conclusively determined by you) for the currency for which the Depositor is liable against the existing currency so converted.

...

9.01 Should any purported obligation or liability of the Customer which, if valid or enforceable, would be secured hereby be or become wholly or in part invalid or unenforceable against the Customer on any ground whatsoever, including any defect in or insufficiency or want of powers of the Customer, or irregular or improper purported exercise thereof, or breach or want of authority by any person purporting to act on behalf of the Customer, or any legal limitation, disability, mental or other incapacity, or any other fact or circumstance, whether

or not known to you, or if, for any other reason whatsoever, the Customer is not or ceases to be legally liable to discharge any obligation or liability undertaken or purported to be undertaken on the Customer's behalf, this security shall nevertheless extend to that obligation or liability or purported obligation or liability as if the same were wholly valid and enforceable. You are not to be concerned to see or enquire into the powers of the Customer or its officers (if the Customer is a limited company), employees or agents purporting to act on behalf of the Customer.

9.02 The Depositor shall not be exonerated, nor shall this security be in any way discharged or diminished or in any way affected by the existence of any defence, set-off or counterclaim which the Customer may have or by you, from time to time, without the assent or knowledge of the Depositor, granting to the Customer or to any other person, any time, indulgence or concession ...

9.04 The Depositor has not taken and will not take any security from the Customer or any security extending to any obligations or liabilities of the Depositor hereunder and your entitlement against the Customer and the Depositor shall not be diminished by the existence of any such security.

...

11. The Depositor hereby undertakes to obtain and maintain in full force, validity and effect all governmental and other approvals, authorities, licences and consents required in connection herewith and to do or cause to be done all other acts and things necessary or desirable for the performance of all the obligations of the Depositor pursuant hereto.

...

12.03 You shall be at liberty to release any one or more of the undersigned from this instrument, to compound with or otherwise vary or agree to vary the liability of, or to grant time or other indulgence to, or make other arrangements with, any one or more of the undersigned, without prejudicing or affecting your rights, powers and remedies against any others of the undersigned." (Emphasis added)

One thing is clear, that nowhere in these clauses does the instrument actually say that the Depositor is to have a liability equal to the amount of the deposit or, for that matter, equal to the amount of the indebtedness of the Company. Thus, if the

Depositor is to succeed he must show that the transaction as formulated cannot be given any meaning unless he is personally liable. When considering this argument two questions must be set on one side. First, whether the words relied on are consistent with personal liability. This they certainly are; indeed it is likely that some of the more inapposite provisions are taken from standard forms of guarantee, embodying personal albeit secondary liability, where they would be completely at home. But this is not the point. Consistency with a liability which could have been expressed is no ground for imposing a liability which was not expressed.

The second immaterial question is whether, if there had been nothing at all in the agreement imposing any liability on the depositor to which the words underlined in clauses 9.02, 9.04, 11 and 12.03 could sensibly be applied, it would have been permissible to treat the agreement as imposing a liability equal to the amount of the Company's liability or perhaps equal to the amount of the deposit, simply to give the words some content. Again, this is not the position under the document as actually drawn, for the Depositor does accept responsibilities beyond the making of the deposit. See, for example, clauses 4, 5, 9.04 and 11. They do not amount to much, but they eliminate that particular ground for reading into the agreement the assumption of a much greater liability which the parties did not choose to express.

Is there any other reason for importing such a liability? Only one calls for mention.

In his thorough argument for the Depositor counsel maintained that since the document was prepared by the Bank it should be construed adversely to the Bank. Whatever weight an argument of this kind might have in a case of ambiguity (and the cases show that it can have some weight, even today) there is no ambiguity here which could give it room to operate. Moreover, the basis of the *contra proferentem* principle is that a person who puts forward the wording of a proposed agreement may be assumed to have looked after his own interests, so that if the words leave room for doubt about whether he is intended to have a particular benefit there is reason to suppose that he is not. This reasoning does not hold good in the unusual circumstances of the present case. If one were to seek the presumed intention of the Bank it would surely be to protect itself by making personally liable anyone willing to assume such a liability; and an omission to make the Depositor expressly liable must tend to show (if it shows anything useful at all) that both the Bank and the Depositor had no such intention. In reality, moreover, an argument based on presumed intention must in the present

circumstances be unrealistic. Documents of this kind are designed to meet the contingencies that the party primarily responsible will be unable to satisfy his obligations and (where further security is taken) that any person assuming a secondary liability will also fail. It is fanciful to suppose that whatever thought the parties may have given to the wording of this agreement would have taken into account the possibility that the lender, not the borrower, might become insolvent.

In these circumstances their Lordships agree with the decision of the Court of Appeal of Hong Kong and will humbly advise Her Majesty that the appeal should be dismissed. The appellants must pay the respondent's costs before their Lordships' Board.