CHARGING ORDERS IN THE DISTRICT COURT

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Section 7 of the District Courts Amendment Act 1983 introduces a new section 96A into the principal Act, permitting the District Court to issue charging orders against

> (a) Any estate, right, or interest in possession, remainder, reversion or expectancy, and whether vested or contingent, in any land:
> (b) Any right or interest in any partnership:
> (c) Any shares in any company incorporated in New Zealand, or having an office in New Zealand in which transfers of shares may be registered.

This section has yet to come into force; presumably it awaits the rules referred to in section 96A(1) before it will be brought into effect by Order in Council.[1] Nevertheless, it represents a major new development in debtor/creditor law, particularly in its announced intention to make the debtor's interest in land exigible in the District Court. Although much of the detail will no doubt be settled in the rules, broad comment on the implications and effects of the new provision is appropriate at this time.

The Present Law

Under the present law, execution in the District Court cannot affect the debtor's land. The creditor who seeks this remedy must have judgment removed to the High Court,[2] and undertake execution there. Execution is a two-stage process: the creditor (a) obtains a "charging order" under Rule 314(a) or (e) of the Code of Civil Procedure; and (b) issues a writ of sale, which gives the sheriff authority to sell the debtor's interest in any land, in terms similar to those used in the new section. It is not altogether clear whether the charging order is absolutely necessary, though it serves the highly desirable purpose of preventing the debtor dealing with the property before the transfer pursuant to the writ of sale is registered and is therefore obligatory in practice. The whole process has as its ultimate end the sale of the property, which must be accomplished within six months of the sealing of the charging order.[3]

So far as the debtor's interest in any partnership is concerned, the new provision is less significant since section 26(2A) of the Partnership Act 1908 already confers on the District Court the power to make an appropriate charging order in such a case. Indeed it is not altogether clear what the legislature hoped to achieve by bringing forward into the District Courts

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1 District Courts Amendment Act 1980, s 1(2).
2 District Courts Act 1947, s 66.
3 Code of Civil Procedure, R 318 (though the period may be extended to a maximum time of two years).

Act the older and less specific provision which still appears in the High Court Code[4] but which appears to have been superseded by the Partnership Act provision. In the case of company shares, the District Court also appears to have the power to make its execution effective[5] but, unlike the High Court, it is unable to use the charging order in support of such execution. To this extent the new provision could serve a useful purpose.[6]

The Purpose of Legislative Reform

The objectives of debtor/creditor law are well stated by the Scottish Law Commission:[7]

> (a) It should seek to provide effective machinery, in which the public have confidence and for which they have respect, whereby creditors can obtain payment of the debts and the implementation of other legal obligations owing to them;
> (b) Within the constraints imposed by the need to maintain an effective system of enforcement, it should have regard to the desirability of protecting debtors and their dependants from undue hardship.

It is not easy to reconcile these two goals, particularly in relation to a debtor's interest in land. It will come as no surprise to readers nurtured in the Scottish tradition that the Commission saw the "first objective . . . [as] necessarily paramount",[8] and indeed it would be surprising if any legislature could tolerate a system under which a debtor were permitted to own a substantial interest in land which was not exigible by creditors. However, there would seem good reason to encourage a creditor to be slow to use the ultimate measure of sale of the debtor's land, if some lesser form of security will achieve the same purpose.

Such an objective, however, is not reflected in the present High Court provisions, where the charging order is simply a preliminary to the ultimate sale and confers no independent rights on the creditor, except as a "stop order" preventing further dealings with the land in the meantime.[9] Nor does it confer any continuing rights after bankruptcy, since it must be perfected by the process of sale under a writ of sale. That process is automatically halted when bankruptcy intervenes.[10] Critics are quick to point out the disadvantages of such a system, as compared with giving the execution creditor a lien or long-term security interest. The latter method ". . . is among the least disruptive of creditors' remedies because it results

4 Code of Civil Procedure, R 315(c).
5 *Malcolm* v *United Copper Mining Co* (1886) NZLR 4 SC 16; but see *Colonial Bank* v *Whinney* (1886) 11 App Cas 426 at 438-440.
6 Though even now, some form of "equitable execution" may be available to the Court, to cure technical defects in its execution processes: see *Sinclair* v *Young* (1964) 11 MCD 112 at 117.
7 *First Memorandum on Diligence: General Issues and Introduction* (Memorandum No 47, 1980) 26.
8 Ibid at 27.
9 See eg *Blaikie* v *Malcolmson* (1886) 4 NZLR 408 at 409; *Brdjanovic* v *Ellis Hardie Syminton Ltd* [1974] 2 NZLR 542 at 543.
10 Insolvency Act 1967, s 50(5).

in a lien that does not usually interfere with the use of the property."[11] If the debtor does not pay off the debt voluntarily the property can be sold; but such a system encourages voluntary satisfaction of the debt, since it affords the creditor some continuing security while the debtor is paying the debt by instalments.

The most appropriate form of execution against land has been debated in England,[12] Canada,[13] and Australia,[14] and there are divergent recommendations on this issue. The debate indicates that New Zealand law might have profited from the discussion which would have been generated by a law reform committee paper, but that is not the usual practice with respect to reforms relating to civil procedure and insolvency.

The English Law Commission appears to have carried the "lien" approach to the point where, as a matter of deliberate policy, a creditor who obtains a charging order against land may retain it even when the debtor becomes bankrupt.[15] The charging order has "the same effect and shall be enforceable in the same courts and in the same manner as an equitable charge created by the debtor by writing under his hand."[16] The charging order is now the normal method of enforcement of a debt against land in England, the old writ of elegit (under which land might be sold) having been abolished.[17] No express provision is made for sale of the property though it is evidently one of the ordinary powers which an equitable chargeholder would have,[18] along with the power to appoint a receiver.[19]

11 California Law Revision Commission, *Tentative Recommendation Proposing the Enforcement of Judgments Law,* 15 Cal L Revision Comm'n Reports 2001 (1980), 2039; cf *Recommendation Relating to Attachment,* 16 Cal L Revision Comm'n Reports 701 (1982).

12 Law Commission, *Charging Orders* (Law Com No 74, 1976) (Cmnd 6412) (hereinafter referred to as "Report").

13 Eg Law Reform Commission of British Columbia, *Report on Execution Against Land* (LRC 40, 1978); Ontario Law Reform Commission, *Report on The Enforcement of Judgment Debts (Part III)* (1981).

14 Eg Law Reform Committee of South Australia, *Thirtieth Report: The Reform of the Law on Execution of Civil Judgments* (1974) 4-6; Law Reform Commission of New South Wales, *Draft Proposal Relating to the Enforcement of Money Judgments* (1975), Draft Bill pp 68-92; Queensland Law Reform Commission, *Civil Proceedings in Supreme Court* (Working Paper 24, 1982) 63 at 69-76; *Writs of Execution, Bills of Encumbrance and Bills of Mortgage, and Caveats* (Working Paper 25, 1982) 2-8.

15 Report, note 12 at 8-10, 12; Charging Orders Act 1979 (UK), s 4, inserting new provisions in the Bankruptcy Act 1914 (UK) s 40(2), and the Companies Act 1948 (UK) s 325. The reform applies to charging orders over goods as well as land.

16 Charging Orders Act 1979, s 3(2) (UK).

17 Administration of Justice Act 1956, s 34 (UK).

18 *Tennant* v *Trenchard* (1869) 4 Ch App 537 at 542; *Dalston Development Pty Ltd* v *Dean* [1967] WAR 176.

19 Administration of Justice Act 1956, s 35 (UK). It is apparently assumed that the chargeholder's rights, in this respect, are equivalent to those of a mortgagee: see 49 *Halsbury's Statutes of England* (3rd ed 1980) 772. There is some difficulty in finding a juristic basis for the appointment of a receiver under the New Zealand provisions in the Code of Civil Procedure, since it should be founded on some legal or equitable right to possession: see *In re Pope* (1886) 17 QBD 743 at 749; and cf Sutton, "Bankruptcy and the Execution Creditor" (1979) 4 Otago L R 340 at 365-366.

The Merits of the Debate

Despite much august discussion, it is surprisingly difficult to find a comprehensive account of the merits of the two alternative systems of execution against land. Even the English Law Commission's recommendation is made in a tentative way; and indeed the Commission indicated its sympathy with the contrary view that execution creditors should not be conferred rights which will survive bankruptcy.[20] The Commission considered, however, that such a view could not be endorsed without a thorough review of the existing English law of bankruptcy.[21] The Commission's recommendation was thus designed to tidy up a practical anomaly,[22] and was not the outcome of any profound study of the intrinsic merits of the scheme itself.

Clearly the most cogent argument in favour of a system of execution charges is that creditors will be enticed away from an early sale of what is perhaps the debtor's most substantial asset. But this masks a more fundamental question, which is whether peremptory execution should be available against a debtor's home, particularly in respect of consumer indebtedness. The provisions of the Joint Family Homes Act 1964 allow quite extensive protection for those who have had the foresight to register their property as a Joint Family Home, though the level of absolute protection ($10,000) has been allowed to lag behind the pace of inflation. The protection afforded by section 20 of the Matrimonial Property Act 1967 protects only the spouse who has not incurred the debt and is much less satisfactory from a debtor's point of view. The present legislative policy in New Zealand is therefore equivocal, yet the question whether to accept the debtor's terms or to press for the sale of the debtor's property seems too important to be left to the discretion of the execution creditor.

As applied to execution against land used for trading purposes, there is not the same emotive appeal in efforts to save the debtor's land. Here the best argument is that ordinary execution processes against land are too peremptory and disruptive of the debtor's business. But this applies equally to all forms of execution, whether it be against land, chattels or money in the bank. It would seem to follow, then, that the system of charge should apply to all major items of a trading debtor's property and not just to land — indeed this was recommended in the California study.[23]

Such a scheme for enforcing judgment debts will lead to considerable complexity as individual creditors vie for priority among themselves, ahead of later holders of securities and the general body of creditors, represented by the Official Assignee. The motto, "the early bird catches the worm", has only superficial attraction in this context. The creditor has not asked for a security at the time of lending the money; should speed in invoking the processes of law, coupled with the happy accident that the debt was incurred during the early stages of the debtor's insolvency, confer a security

20 Report, supra n 12 at para 32.

21 Ibid at para 35.

22 Under the existing legislation, priority over bankruptcy could be obtained as long as a receiver was appointed: *In re Overseas Aviation Engineering (GB) Ltd* [1963] ch 24. The Commission saw the appointment of a receiver as an otiose step and recommended that the charge take full effect without it.

23 *Tentative Recommendations,* supra n 11 at 2045-2048.

right? Such a proposition is implausible when placed alongside other provisions of our bankruptcy law, which enable the Assignee to set aside preferential transactions[24] and securities given for pre-existing debts.[25] It is unreasonable to contend that the law should give the creditor rights which the debtor cannot give; if implemented, the proposal could provide a ready device for those who wished to enter into preferential transactions, since preferential intention will be difficult to detect where the creditor is merely following the ordinary processes of law.

These logical and technical points militate strongly against allowing an execution creditor to obtain a security interest through the processes of execution. Nevertheless, it is to be hoped that, on any broader review of the question, technical considerations will not prove to be decisive. Given that, in the great majority of instances, collection of debts is a matter of consensual arrangement between debtor and creditor rather than the application of coercive procedures, a critical question is whether the powers conferred on creditors give them sufficient, or undue, bargaining leverage in dealing with debtors; whether they sufficiently encourage informal arrangements for payment; and whether, when invoked, they lead to efficient or wasteful use of social and private resources in concluding matters.[26] These considerations will in time lead to a more thoughtful assessment of existing procedures, which have changed little since the last century. Already in the United States, constitutional issues have been raised in respect of some of these procedures, and much work has been done on re-designing them, especially in relation to pre-judgment proceedings. The option of attachment without seizure or sale has considerable attraction,[27] and deserves serious thought in New Zealand. The technical problems such proposals bring in their wake are not incapable of resolution, if the will to reform is there.

The Intention of Section 96A

The new provisions of section 96A draw New Zealand enforcement procedures more towards the present English law. No doubt they will in due course be filled out by rules, but the general pattern of the legislation is already fairly well established. It seems clear that, at least as far as land is concerned, the District Court charging order will be an independent right, rather than a "stop order" which looks forward to a later process of execution.

The clearest indication of this is the fact that the distress warrant provision of the District Courts Act[28] has not been amended and remains in-

Insolvency Act 1967, s 56.
Ibid, s 57.
See generally Whitford, "A Critique of the Consumer Credit Collection System" [1979] Wisconsin L R 1047.
See eg Zaretsky, "Attachment Without Seizure: A Proposal for a New Creditors' Remedy" [1978] Illinois L F 819.
District Courts Act 1947, s 85.

capable of application to land.[29] Also, the words of the new section treat the new right as if it were a mortgage. They speak of "a charge in favour of the person who obtained an order", and "the property on which such charge is to be imposed",[30] words which indicate more than the "stop order" concept which prevails in the High Court. It is difficult to resist the inference that the legislature has moved away from the method of execution against land which has previously applied in New Zealand, and quite some distance towards the modern English conception of a charging order.

The practical consequences of such a move will be considerable. A creditor, by getting the charge registered on the title,[31] will assume in many respects the position of a mortgagee. There will be no need to perfect the charge by issuing a writ of sale within a specified time. Should a prior encumbrancer sell the property so that the debtor's interest in the land is transformed into a right to the surplus after the mortgagee sale, the charge will not be useless (as seems to be the case under the present law, since a writ of sale cannot reach it). Instead, the creditor will be entitled to the surplus.[32] If the debtor becomes bankrupt, but the creditor has previously appointed a receiver, then the creditor may arguably have "completed" the execution within the meaning of the Insolvency Act 1967[33] so as to become a secured creditor in the bankruptcy, though that is more doubtful.

In view of the enlarged effect a District Court charging order will have (as compared with its High Court counterpart) it may well be that the order will be issued more sparingly. In the High Court, where the debtor is named on the title to land the order issues as of right,[34] subject to the right of any person "prejudicially affected" to apply to have the order cancelled.[35] The new legislation provides that the creditor "may apply to the court" for a charging order; presumably the District Court will have a discretion whether it will issue the order or not. Recent English authority has shown that the court should take a fairly wide view of its functions, having regard

29 The provision for recovery of land under s 99 of the District Courts Act is clearly inappropriate for the purpose of a general execution, since it implies foreclosure under the charge. This would be inadmissible in New Zealand: Property Law Act 1952, s 89.

30 District Courts Act 1947, s 96A(a). Compare RR 317 and 322 of the Code of Civil Procedure, which define the effect of the charging order as being to restrain dealings by the debtor, or to deprive them of legal effect.

31 Under District Courts Act 1947, s 96A(5).

32 Under Land Transfer Act 1952, s 104(c).

33 Section 50(2) of the Insolvency Act provides that "an execution of land is completed by sale or, in the case of an equitable interest, by the appointment of a receiver": see *In re Overseas Aviation Engineering (GB) Ltd* [1963] Ch 24 (under corresponding company law provisions – see, in New Zealand, Companies Act 1955, s 314, as substituted by Companies Amendment Act 1980, s 51(3)). If the term "equitable interest" referred to in s 50 of the Insolvency Act is that of the debtor, it would appear that those words could have no application to District Court charging orders: see supra n 31. But it may refer to the equitable rights conferred on the creditor by his charging order. The corresponding English sections (Bankruptcy Act 1914, s 40; Companies Act 1948, s 95) have always been worded differently.

34 Code of Civil Procedure, R 315.

35 Ibid, R 320.

to the interests of other creditors.[36] If the other creditors can get rid of a charging order by instituting bankruptcy proceedings, it may be difficult for them to claim that, as a group, they are prejudiced by its existence; but the position is different if there is a possibility that the charging order will survive a bankruptcy, or confer greater rights than ordinary execution.

It may be expected, therefore, that there will be a substantial departure from the system of charging orders developed under the Code of Civil Procedure, and this may have an appreciable effect both on the legal consequences of the charging order and the court's practice in allowing charging order to issue. Nor can it be supposed that if this is the legislative intention, the provisions of the Code of Civil Procedure, applicable to the High Court, will be allowed to remain in their present form. In this respect, it is of interest that section 96A(8) will allow a District Court charging order to be removed to the High Court.[37] Unless reforms are made to the Code anomalies would arise; a High Court charging order would have different effects depending upon whether it originated in the High Court or the District Court.

The Ambit of the New Provision

Questions remain about how extensive the new provision is going to be. Does the section empower the court to charge a debtor's equitable interest in land — for example, rights under a long term sale and purchase agreement? Section 96A is ambiguous on the point. A very clear distinction is made in the Code of Civil Procedure. A debtor's legal interest in land is chargeable under Rule 314(a), which refers to property held by "such opposite party in his own name". An equitable interest in land is, it seems, classified as an "estate, right or interest . . . in any land . . . under or by virtue of any express or implied trust".[38] At first sight, it would appear that section 96A obscures that distinction. Subsection (1) refers to property to which the judgment debtor is beneficially entitled", and omits any reference to the land being held in the debtor's name. On the other hand, subsection (2) says that the charging order takes effect subject "in the case of any real property to registration under subsection (6) of this section ...";[39] and subsection (6) permits registration only in respect of "the registered estate or interest of the judgment debtor in any land . . . ."

Roberts Petroleum Ltd v *Bernard Kenny Ltd* [1982] 2 AC 192. Their Lordships' decision indicates that the discretion is even wider than was supposed in the earlier case of *Burston Finance Ltd* v *Godfrey* [1976] 1 WLR 719, which was followed by the New Zealand Court of Appeal in *Molyneux* v *Cramp* [1980] 1 NZLR 713 at 719 (as applied to the court's discretion to make a charging order absolute in respect of moneys due and accruing due — Code of Civil Procedure, R 326).

Under District Courts Act 1947, s 66.

Code of Civil Procedure, R 314(e). The practical consequence is that, where the debtor's interest is equitable, a charging order nisi has to be made in the first instance, followed by an application to the court to make the order absolute.

The concluding words would seem to prevent the application of the Statutory Land Charges Registration Act 1928, but interesting questions are raised by s 4(2) of that Act, which says that its provisions shall apply "notwithstanding anything to the contrary in any enactment under which a charge is created or arises".

Thus, if the section as a whole is read literally, there is no provision for charging equitable interests in land. It will be noted that under the new section the District Court will have no power to issue execution against trusts or equitable interests generally. But it seems that charging orders will issue against the debtor's equitable interest in shares and partnerships, and it is not easy to see why as a matter of policy the same should not apply to land. As the Code of Civil Procedure demonstrates, there is no practical difficulty in noting charges against equitable interests on the register, if necessary by caveat.[40]

Another unresolved problem in the application of section 96A arises with shares on which the articles of the company impose restrictions against transfer. As shown by the West Australian case of *Dalston Development Pty Ltd* v *Dean,*[41] considerable practical difficulties can arise in enforcing a charge in such a case, because of the principle that no execution process should give the execution creditor greater rights than the debtor possesses. Thus, if there are pre-emptive rights, or provisions allowing the directors to refuse to register a transfer of shares, these have to be respected. It is to be noted that, in the District Court provisions governing garnishee proceedings,[42] the interest of the execution creditor in getting to a debtor's bank account is made to override some of the more technical barriers placed in the way by contractual stipulations in the contract between the debtor and the bank. Perhaps something similar is envisaged for the Rules under section 96A. Nevertheless, it would be surprising if the rules made any great inroads into the general principle that existing rights of third parties should not be compromised by an execution.[43]

Conclusion

The patterns of execution adopted in the High Court have changed little since their introduction in the 1880s and, in view of the considerable interest this topic has generated in overseas law reform circles, it can hardly be contended that a general review is untimely. However, since the law is embodied in the Code of Civil Procedure, any review is, in the first instance, the responsibility of the Rules Committee;[44] it is thus not subject to the ordinary processes of law reform. Changes in the law seem more likely to come through amendments to the District Courts Act, which is administered by the Department of Justice. Indeed, the new section 96A is the second review of execution procedures, the other being the alterations made to the garnishee procedure in respect of bank accounts in the District Court[45] (to which one might possibly add the provisions for summary

40 Code of Civil Procedure, R 321.

41 [1967] WAR 176.

42 District Courts Act 1947, s 96, as amended by District Courts Amendment Act 1971, 10; District Court Rules 1948 (SR 1981/259), RR 267A, 272A, as inserted by Magistrate Courts Rules 1948, Amendment No 12 (SR 173/244), RR 16, 17.

43 For further discussion of the application of charging orders to shares, see *Report,* sup n 13 at 5-6, 11, 25-28.

44 Established by Judicature Amendment Act 1930, s 2, as substituted by Judicature Amendment Act (No 2) 1968, s 2.

45 Supra n 42.

stalment orders).[46] These are far from being purely procedural matters, nce they are capable of working basic changes in the law governing the ghts of debtors and creditors. The provisions of section 96A have slipped to our law relatively unheralded, but they make the greatest changes yet the traditional methods of debt enforcement in New Zealand. Perhaps e time has come to review debtor and creditor law in a way which will ıgender a greater degree of public and professional discussion.

Insolvency Act 1967, Part XVI.