HIGH PRIORITY

IN THE COURT OF APPEAL OF NEW ZEALAND CA 264/96

BETWEEN C N & N A DAVIES LTD

Appellant

A N D I C J LAUGHTON AND ANOTHER

First Respondent

A N D PARKS

Second Respondent

Coram: Richardson P
Gault J
Henry J
Thomas J
Keith J

Hearing: 8 April 1997

Counsel: G J Judd QC for Appellant
A L Hassall QC for First and Second Respondents

Judgment: 21 July 1997

JUDGMENT OF THE COURT DELIVERED BY THOMAS J

The question in issue

Indefeasibility of title is a vexed subject which has given rise to numerous cases and even more articles. The question in issue in this appeal is simple enough, however, and does not require an exhaustive examination of the authorities and material on the subject.

The issue is whether, notwithstanding the doctrine of indefeasibility of title, the respondents can sustain a claim *in personam* against the appellant, the registered

proprietor of the mortgage which they executed, on the ground that the mortgage was security for a guarantee and the mortgagee altered the terms of its contract with the principal debtor without the mortgagors' knowledge or authority.

As the issue arises in the context of an interlocutory application it is only necessary for the respondents to establish that their cause is seriously arguable.

The relevant facts

Mr and Mrs Laughton, the respondents, wished to help their son buy a business. On 18 August 1990, he entered into an agreement to purchase the importing business of Davies in the name of Preform Company 403 Ltd. Mr and Mrs Laughton agreed to provide a mortgage over their home in Dunedin to secure the sum of $75,000.

The agreement for the sale of the business required certain goodwill payments to be made after the date of settlement. A subsequent variation provided that these payments would be secured by a second debenture, subject to a prior first debenture securing $450,000, to be guaranteed by the son, a second mortgage over Mr and Mrs Laughton's property in Dunedin, subject to a prior first mortgage securing not more than $40,000, and a registered third mortgage over the son's property in Auckland for the sum of $25,000. The agreement provided that the son's solicitors, Parks, were to prepare and obtain the completion of the mortgage from Mr and Mrs Laughton. Parks sent the memorandum of mortgage to them for execution on 21 November 1990. It purported to secure the amount of $159,100 but, after some discussion with Parks, this sum was reduced to the agreed figure of $75,000. The mortgage was then signed by Mr and Mrs Laughton and returned to Parks on 27 November 1990.

For the purpose of disclosure under the Credit Contracts Act 1981 copies of certain clauses in the agreement for the sale of the importing business were also forwarded to Mr and Mrs Laughton. Clause 26 of the agreement confirmed that the payments due by Preform would be secured by a second debenture subject to the first debenture securing an amount of $450,000. Later in the month Parks sent a retyped

mortgage to Mr and Mrs Laughton including a new clause, clause 14. This clause provided that the mortgage would be collateral with the second debenture given by Preform and the third mortgage given by their son. It stipulated that default under any of these securities would be deemed to be a default under the others, with the intent that the mortgagee could proceed under all securities together or any of them independently. Mr and Mrs Laughton promptly signed the retyped mortgage and returned it to Parks.

At the request of Davies' solicitors, Parks then deleted the word "second" from clause 14 so that the mortgage became collateral to a first debenture and not to a second debenture. Mr and Mrs Laughton were unaware of this alteration.

Also unbeknown to Mr and Mrs Laughton, Davies later cancelled the agreement with Preform on the ground that the purchaser had not completed settlement as required. A new agreement, of which they were also unaware, was entered into which reinstated the original agreement but which inserted an amendment requiring Preform to provide certain letters of credit by 16 January 1991. This obligation was also included in the debenture.

The sale and purchase of the business was then settled on 21 December 1991. Preform subsequently failed to comply with the requirement that it provide the letters of credit and Davies duly appointed receivers to the company on or about 1 February 1991. The receivers sold the business but the proceeds of the sale were insufficient to recover the full debt due to Davies. That company duly sought to exercise the power of sale pursuant to the mortgage and sell Mr and Mrs Laughton's house.

The proceeding

Davies served a s 92 Property Law Act default notice on Mr and Mrs Laughton. The alleged default was their failure to pay the principal sum of $75,000 on the due date plus penalty interest at the rate of 20% to the date of the default notice.

Various proceedings ensued. Mr and Mrs Laughton sought an interim injunction to restrain Davies from proceeding with the mortgagee sale. Believing that it would be more effective to obtain a substantive hearing as a matter of urgency, Davies' legal advisers consented to the interim injunction. They subsequently concluded, however, that this move had been misguided and applied to discharge the interim injunction. The application was heard by Blanchard J. In a reserved judgment delivered on 8 May 1996 the learned Judge declined the application. (Reported as (1996) 3 NZ Conv C 192,356).

Davies appealed to this Court against that decision.

In their proceeding, Mr and Mrs Laughton have pleaded eight causes of action. For the purposes of this appeal only three are material, the third, fifth and eighth causes of action.

The third cause of action alleges misrepresentation on the part of Parks acting as Davies' agent in the preparation and execution of the mortgage. Mr and Mrs Laughton allege that they were induced to enter into the mortgage as a result of misrepresentations made to them by Parks, as Davies' agent, relating to the securities given in respect of the transaction. They claim to be entitled to cancel the mortgage under the Contractual Remedies Act 1979. Blanchard J held that, subject to the question of indefeasibility, this cause of action disclosed a seriously arguable point.

The learned Judge held, however, that the fifth cause of action did not raise a serious question. In this cause of action Mr and Mrs Laughton claim that the mortgage is void and unenforceable because the deletion of the word "second" in clause 14 of the mortgage was a material alteration made without their knowledge or consent when Parks had custody and control of the mortgage. Blanchard J did not consider that the deletion was material in relation to the validity of the mortgage. There is no cross-appeal against this finding.

In the eighth cause of action, Mr and Mrs Laughton claim that the mortgage which they executed is a contract of guarantee by which they guaranteed payment of an amount not exceeding $75,000 of the monies payable by Preform pursuant to the agreements of 18 August 1990 and 16 September 1990. They then allege that the alterations to the agreement, that is, deleting the word "second" and requiring the provision of letters of credit, were made without their knowledge and consent and that, as a result, they are discharged from liability. The learned Judge concluded that this cause of action also raised a serious question to be tried.

The judgment at first instance

Mr Judd QC, who appeared for Davies, confronted Blanchard J with an argument based on indefeasibility of title under the Land Transfer Act 1952. He argued that the effect of registration of the mortgage was to confer an indefeasible title on Davies as the mortgagee by virtue of ss 41, 62 and 63 of the Act. It was not suggested that fraud or any other exception contained in s 63 has any application to the facts of the case.

Mr Judd submitted, referring to the decision of Barker J in ***Congregational Christian Church of Samoa Henderson Trust Board v Broadlands Finance Ltd*** [1984] 2 NZLR 704, that the mortgagee's power of sale is part of the indefeasible title enjoyed by Davies. Blanchard J indicated that he would have no hesitation in agreeing with that submission if Mr and Mrs Laughton's obligation were to repay sums directly advanced to them by Davies. The learned Judge considered, however, that if their obligation to pay was in truth a collateral obligation of guarantee, that is, a secondary obligation to answer for the primary obligation of another then, if the secondary obligation no longer existed, nothing remained to be indefeasibly secured by the mortgage.

Citing ***Frazer v Walker*** [1967] AC 569; [1967] NZLR 1069, as authority, Blanchard J accepted it as being beyond argument that, where the mortgage secures a primary obligation, the mortgagee's right of recovery by resorting to the security, that

is, exercising the power of sale, enjoys the protection of ss 62 and 63, even in the case of forgery. He considered that the position is different, however, when what is secured is a secondary obligation under which monies are no longer payable (if that be the case). Ordinary principles of the law relating to guarantees apply regardless of the registration of the security for the guarantors' obligation. In other words, the Judge held it is arguable that the security created by the mortgage is extant, as it is indefeasible, but no underlying obligation remains in respect of which the security can operate.

Blanchard J dealt with the argument advanced by Mr Judd to the effect that the mortgage is not on its face a security for an obligation by way of guarantee by adverting to the equitable rule that, in looking at the rights of a debtor, the Court will take into account the knowledge of the creditor about the true position of those who have undertaken obligations to that creditor. Although the question whether someone has acted as a principal or a surety must be ascertained from the terms of the document creating the obligation; "Yet," the learned Judge said, "notwithstanding that the debtor may be a principal *vis a vis* the creditor, if that debtor nevertheless is acting as a surety for a second debtor and if it is established that the creditor had known that to be the case, the creditor's dealings with another (principal) debtor may raise an equity in favour of the one who is in reality a surety entitling him to the protection of a Court of equity". ***Hollier v Eyre*** (1842) 9 Cl & Fin 1, at 45; 8 ER 313, at 332, was cited as an authority.

Blanchard J then held that Davies must have known throughout that Mr and Mrs Laughton were not themselves participating in any borrowing or acceptance of credit from Davies but were assisting their son and his company and that, as between Preform and themselves, they were merely acting as sureties. If, with this knowledge, Davies bound itself to a material variation of the principal obligation of Preform without Mr and Mrs Laughton's authority, they would be released from the mortgage over their home as it would no longer secure any obligation. The Judge concluded, "...if a creditor causes, requires or requests someone to enter into a written instrument which the creditor is aware will, upon its coming into operation, make that person, as

between that person and another debtor, a surety, then, if the creditor agrees to change the terms of the obligation which the creditor knows to be the primary obligation and does so in a way which is not obviously immaterial and without troubling to obtain the consent of the person who has executed the document, that person will be discharged just as much as he or she would have been had the variation occurred after the document became operative". "In other words," the Judge added, "an unconsented material variation will release a prospective guarantee, so as to prevent it ever coming into operation, just as much as it will release an existing guarantee".

Concluding, therefore, that a serious question remained to be tried concerning the enforceability of the mortgage, Blanchard J declined the application.

Indefeasibility and claims in personam

It is well settled that the doctrine of indefeasibility of title does not deprive the Courts of their equitable jurisdiction. A claim *in personam* against the registered proprietor may be maintained in respect of a transaction involving the claimant and the registered proprietor. Providing no conflict with the title exists, the recognition of an *in personam* remedy is not inconsistent with the concept of indefeasibility and the objective of protecting persons who deal with the registered proprietor on the face of the register.

Clear confirmation of the principle that the indefeasibility provisions of the relevant statute do not affect an equitable *in personam* remedy based upon a transaction to which the plaintiff and the defendant are parties is to be found in the Privy Council's decision in ***Oh Hiam v Tham Kong*** [1980] 2 BPR 9451. Lord Russell, delivering the judgment of the Board, proffered (at 9453-9454) a number of other examples where the Courts intervene to enforce an equitable remedy. A registered proprietor who has entered into a contract for the sale of land, for example, cannot set up the indefeasibility of his or her title as a defence to a proceeding for specific performance. Nor can a registered proprietor who holds the land upon trust rely upon the concept of indefeasibility to defeat the trust. The Courts will intervene

to protect the beneficiaries by directing that the trust be executed notwithstanding the doctrine of indefeasibility.

Lord Russell pointed out that the Privy Council in ***Frazer v Walker***, while recognising that the registered proprietor is immune from adverse claims because of the concept of indefeasibility inherent in the system of registration under the Land Transfer Act, made it clear that "this principle in no way denies the right of a plaintiff to bring against a registered proprietor a claim *in personam*, founded in law or in equity, for such relief as a Court acting *in personam* may grant". His Lordship referred to ***Boyd v Mayor of Wellington*** [1924] NZLR 1174, at 1223, and ***Tataurangi Tairuakena v Mua Carr*** [1927] NZLR 688, at 702, as examples of earlier cases in which this principle had been recognised in New Zealand.

It has also been accepted by the High Court of Australia that neither the relevant statute nor the principle of indefeasibility precludes a claim to an estate or interest in land against a registered proprietor arising out of the acts of the registered proprietor him or herself. See, e.g., ***Breskvar v Wall*** (1971) 126 CLR 376, at 384-385, and ***Bahr v Nicolay (No. 2)*** (1987-88) 164 CLR 604, at 613. An equity against a registered proprietor arising out of a transaction taking place after he or she became registered as a proprietor may be enforced against them. See ***Barry v Heider*** (1914) 19 CLR 197. So, also, an equity arising from the conduct of the registered proprietor before registration may be recognised and enforced so long as there is no conflict involved with the statute. See ***Logue v Shoalhaven Shire Council*** [1979] 1 NSWLR 537, at 563. As Brennan J states in ***Bahr v Nicolay*** (at 653) the indefeasibility provisions of the statute are designed to protect a transferee from defects in the title of the transferor, not to free him or her from an interest with which they have burdened their own title.

The express reservation in ***Frazer v Walker,*** now endorsed by the further declaration in ***Oh Hiam v Tham Kong*** (at 9454), that the concept of indefeasibility does not interfere with "the ability of the Court, exercising its jurisdiction *in personam* to insist upon proper conduct in accordance with the conscience which all men should

obey" leaves no room for doubt. Rights *in personam* may be enforced against a registered proprietor notwithstanding the doctrine of indefeasibility of title.

Indeed, it has been widely recognised that the concept of indefeasibility of title is something of a misnomer. Certainly, it is far from absolute. A subsequent registration by a new registered proprietor who can claim an indefeasible title may defeat the "indefeasible title" of an earlier registered proprietor. An indefeasible title may become defeasible. Exceptions recognised in the Land Transfer Act itself are far from insubstantial, and the *in personam* principle encompasses not only rights arising in equity but also rights arising at law.

Nor are the limits or scope of claims *in personam* closely defined. Lord Wilberforce in ***Frazer v Walker*** expressly stated (at 1079) that the cases referred to were by way of illustration only and that the Board did not intend to limit or define the various situations in which actions of a personal character against registered proprietors may be admitted. Any numbers of cases, particularly in New Zealand and Australia, provide ample illustration of the wide circumstances in which claims *in personam* have been recognised in such circumstances.

In our view, therefore, indefeasibility of title does not interfere with the personal obligations of a registered proprietor, and the principle that contracts, or trusts, or any personal equity can be enforced against the registered proprietor merely serves to indicate the limits of the doctrine. The Privy Council's reference in ***Oh Hiam v Tham Kong***, (approving a statement from ***Wilkins v Kannamal*** [1951] MLJ 99) to the Torrens system being a system of conveyancing which does not abrogate the principles of equity, is entirely appropriate. The Board emphasised that it alters the application of particular rules of equity only so far as is necessary to achieve its own special objects. The Land Transfer Act is a conveyancing enactment giving greater certainty of title but not an enactment which in any way destroys the fundamental doctrines by which Courts of equity may enforce, as against registered proprietors, the "conscientious obligations entered into by them". The Courts retain their jurisdiction in equity.

Properly perceived, the principle sits comfortably with the concept of indefeasibility. Designed to protect a transferee from defects in the title of the transferor and not to release him or her from the burden of interests which they may have undertaken, the principle has as its basis the enforcement of personal claims arising out of the registered proprietor's conduct. It is essentially non-proprietary in nature. The key element is the involvement in or knowledge of the registered proprietor in the unconscionable or illegal act or omission in issue. It is such involvement or knowledge which gives rise to the equity or legal right in the innocent party as against the registered proprietor in person. Indefeasibility is no answer to a claim based on such an equity or legal right. When granted, it is true, a remedy may restrict the registered proprietor in what he or she can do or require them to give up in whole or in part their registered interest, but until that event occurs the title remains conclusive as against third parties. See, e.g., ***Breskvar v Wall***, supra, at 384-385.

Nor is there any detriment to the objective of indefeasibility. It is now over a century since the nature and purpose of the Torrens system was described by the Privy Council in ***Gibbs v Messer*** [1891] AC 248, at 254. The object is to save persons dealing with registered proprietors from the trouble and expense of going behind the register in order to investigate the history of the title and to satisfy themselves of its validity. This end is accomplished by providing that everyone who purchases land, without fraud and for value, from a registered proprietor and enters his or her deed of transfer or mortgage on the register thereby acquires an indefeasible right notwithstanding any infirmity in the title. Admitting *in personam* claims against a registered proprietor whose very acts or omissions give rise to the claim does not compromise this objective.

Mr Judd nevertheless urged that the present case could not be distinguished from ***Frazer v Walker*** and ***Boyd v Mayor of Wellington.*** Assuming for the purpose of argument that the mortgage secures a contract of suretyship and that it is unenforceable because a material variation had been made to the underlying obligation by the mortgagee's agent, Mr Judd contended that the mortgage was no different in

character from a mortgage which is a nullity because it has been forged or because a proclamation taking land is void. The above brief resume of the *in personam* principle, however, discloses a significant distinction. In ***Frazer v Walker*** the registered proprietor was not involved in or aware of the forgery which proceeded the registration of the transfer. Registration cured the defect in his title and the transferee obtained a valid title. Only fraud on the registered proprietor's part would have vitiated the title. But short of fraud, the mortgagor in that case could still, if a claim *in personam* in either law or equity had existed, have sought to establish that claim as against the registered proprietor. In the present case Davies, through its agents, Parks, was responsible for the arguably material alterations made to the underlying obligation which the mortgage was intended to secure, so that registration does not have the effect of curing a defect in the title because there was no defect as such. Rather, by virtue of making material alterations to the bargain between the debtor and creditor without the mortgagor's knowledge or consent, the company relinquished the benefit of an incidence of its title which equity will not now allow it to deny. As against the world, however, its title remains indefeasible.

It is the fact that an *in personam* claim arises out of the knowing acts of the registered proprietor that marks the distinction. Mr and Mrs Laughton are not seeking, as argued by Mr Judd, to recover the estate or interest which they gave away when the mortgage was registered. What is being challenged is not the validity of the registered title, as in ***Frazer v Walker***, but the freedom of the registered proprietor to disregard an equity arising out of its unilateral alteration to the liability which Mr and Mrs Laughton undertook as guarantors.

But is there an equity?

For the purposes of the appeal, Mr Judd accepted that it is arguable that as between Mr and Mrs Laughton and their son and Preform, the former were sureties for the latter; that Davies knew this to be so; and that there were material variations to the contract between Davies and Preform after Mr and Mrs Laughton executed the mortgage, but before settlement, when the mortgage was made available to Davies as

part of the settlement. It is accepted that these propositions rest upon assumptions as to fact which Mr and Mrs Laughton will have to prove if the case goes to trial.

Mr Judd nevertheless sought to persuade the Court to reject Mr and Mrs Laughton's claim to an equity. Unless Davies became registered as proprietor of the mortgage by fraud against Mr and Mrs Laughton, he argued, it cannot be prevented from exercising the rights conferred by the document. The principle of indefeasibility is paramount. Upon registration, by virtue of s 41, the estate or interest specified in the mortgage passed or the land became liable for the security in the manner and subject to the covenants, conditions, and contingencies set forth in the mortgage or implied by the Land Transfer Act. In terms of s 62 Davies was entitled to hold its estate as mortgagee absolutely, free from all encumbrances, liens, estates, or interests other than those notified on the folium of the register, except in case of fraud. In terms of s 63(1) no action for possession, or other action for the recovery of any land (which in terms of the definition of land includes a mortgage), may lie or be sustained against the registered proprietor under the provisions of the Act for the estate or interest in respect of which the mortgagee is so registered except, being the only conceivably relevant provision, the case of a person deprived of any land by fraud, as against the person registered as proprietor of the land through fraud. In terms of s 63(2) the plaintiffs are absolutely barred from taking action against the appellants, "any rule of law or equity to the contrary notwithstanding". Thus, he argued, the mortgage, once registered, must take effect according to its tenor, unless one of the statutory exceptions is applicable.

It is accepted that the words in s 63(2), "any rule of law or equity to the contrary notwithstanding", have the effect of preserving the estate of Davies as mortgagee and the power of sale contained in the registered mortgage. Mr Hassall QC, who appeared for Mr and Mrs Laughton, did not take issue with this proposition. But the words do not have the effect of enabling Davies as mortgagee to exercise the power of sale on the basis that Mr and Mrs Laughton are in default if no such default has occurred. The arguable point is that no default occurred because no obligation arose or existed. The contract of securityship was extinguished, or never came into force, because of Davies'

unauthorised variations of the principal debt. Mr Judd is therefore in error in suggesting that Blanchard J held that the equity had the effect of overriding s 63(2). Rather, s 63(2) does not take effect in respect of a liability which has been discharged or never came into existence. The effect of the equity is analogous to the position where a mortgagor has discharged the debt or the mortgagee has earlier forgiven the debt. In such circumstances the mortgagee cannot sue for the recovery of the secured sum under the mortgage, irrespective that the mortgage remains on the title.

Consequently, Mr Judd necessarily had to refute Mr and Mrs Laughton's claim to a remedy *in personam* based on the equitable principle relied upon by Blanchard J. Mr Judd did not take issue with the principle as such. Rather, he contended, the principle does not apply to a "prospective" guarantee and the guarantee in issue remained prospective until settlement when the mortgage was made available to Davies. Prior to then, Mr and Mrs Laughton were not under any liability. While they may have executed the mortgage in anticipation, Preform's indebtedness was not in fact guaranteed by them until settlement had taken place. For present purposes, therefore, Mr Judd argued, the relevant contract is the contract at the time the guarantee is given, and not some earlier variation of it. In other words, it is not possible to release a prospective guarantee as this contemplates the "release" of an obligation which does not exist at the time of the "release".

We also reject this argument. It is decidedly strained to claim that the equitable principle in issue cannot apply simply because at the time the principal debtor's obligation was unilaterally altered, the guarantee can be described as "prospective". At issue is an equitable principle, and equity is not to be so narrowly confined. The Courts, as the Privy Council stressed, have reserved the jurisdiction *in personam* to insist upon equitable conduct in accordance with "the conscience which all men should obey". The conscience of a mortgagee who, unbeknown to the mortgagor, alters the terms of the debtor's obligation which the mortgage is to secure, must be pricked as assuredly as if the alteration were made after settlement. Indeed, to accept that the responsibility for ensuring that the agreement had not been altered rested on Mr and Mrs Laughton up to the date of settlement notwithstanding that the executed mortgage

was in the possession of Davies' agent is an affront to equity. A hapless guarantor who has been exploited in this way is just as entitled to the protection of a Court of equity as one whose liability has been altered following settlement or registration. Acting behind Mr and Mrs Laughton's back in making material alterations to the agreement and debenture before settlement is no less unconscionable. Moreover, the argument is highly artificial for, as at the date of settlement, the mortgage was made available to Davies who, at that time, through its agent knew of the alteration and that it was not authorised by Mr and Mrs Laughton. Yet, they proceeded to complete settlement and register the mortgage.

In our view, therefore, Mr and Mrs Laughton certainly have an arguable claim to an equitable remedy against Davies. The concept of indefeasibility, to the extent it is incorporated in ss 62 and 63 of the Land Transfer Act, protects the title of Davies to the mortgage, but does not prevent the Court from upholding Mr and Mrs Laughton's claim *in personam* that nothing is owing under the mortgage and that they are therefore entitled to a discharge.

The appeal is dismissed. Costs will be awarded to the respondents in the sum of $3,500, together with such disbursements, including accommodation and travelling expenses, as may be agreed or, failing agreement, determined by the Registrar.

Thomas J

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