Mortgage of shares to bank – memorandum of deposit – terms of equitable mortgage – effect of unilateral alteration of the memorandum of deposit by bank – rule in Pigot's Case – whether mortgage rendered void.

IN THE HIGH COURT OF JUSTICE IN NORTHERN IRELAND

CHANCERY DIVISION

2000 No 54

BETWEEN:

NORTHERN BANK LIMITED

Plaintiff;

and

GERALD FRANCIS LAVERTY

Defendant.

GIRVAN J

1. This case illustrates graphically the volatility of so-called "hi-tech" shares and the fortunes which may be won or lost by speculating in such shares. It involves a holding of shares in an Israeli company Geo Interactive Media Group Limited ("Geo") which the defendant acquired by means of bank loans and which became the subject of a mortgage in favour of the Northern Bank Limited ("the Bank"). The case raises a number of points relating to the requisite form of such a security, the nature of such security and the rights and the remedies exercisable by the secured creditor. It also raises issues in relation to the ancient rule in Pigot's Case showing how ancient law can still impact on modern life.

The Bank Accounts

2. The defendant is a young man who resides in Ballycastle, a plumber by background, who operated a fish and chip shop in the town. He developed an interest in the stock market and spent much time in following the financial press and in gathering information via the internet about potentially good investments.

3. He operated a number of bank accounts at the Ballycastle Branch of the Bank. "Account A" was opened in May 1986. This was a personal account in which interest was payable on any overdraft at the rate of Northern Bank base rate ("base rate") plus 5%. "Account B" was operated in the name of the defendant's fish and chip business. It was opened in December 1996. The contractual rate of interest on that account was base rate plus 4%. Account C was a regulated consumer credit agreement in which the contractual rate of interest was 14% per annum. This account was opened in September 1997. The amended statement of claim claimed that there was a further account ("Account D"). The defendant alleged that this account had been operated fraudulently by the Bank. The amount allegedly owing on that account is small and the parties agreed that the Bank's claim on foot of that account should be taken out of the present action and, if necessary, pursued in separate proceedings. The parties agreed that no point will be taken about it being dealt with in separate litigation.

4. The principal sums due on Accounts A, B and C, which were stopped and called in on 23 November 1998, are not in dispute. On Account A the debt due is £538.42. On Account B the principal sum due is £72,580.27. On Account C the principal sum due is £3,954.84. The defendant admits interest on those accounts at the contractual rates referred to above but contends that interest stopped as at 31 March 1999 for the reasons which

appear hereafter.

The dispute between the parties

5. In May 1998 the defendant approached Mr Bennett, the Bank Manager at the Ballycastle Branch, to increase his overdraft facility to £70,000 to enable him to acquire 53,000 shares in Geo which, according to the defendant's extensive researches, would be in his opinion a very good investment. At that stage the defendant's overdraft stood at £11,000 and he had an overdraft facility of £55,000. His request for the extended overdraft facility was for six months. Mr Bennett unreservedly recommended the advance to his superiors. The defendant's existing indebtedness of £11,000 was subject to the security of a number of shares deposited with the Bank and supported by a memorandum of deposit containing terms entitling the Bank to sell those shares at any time. The Head Office of the Bank sanctioned the increase of the overdraft to £70,000 and the facility was taken up in June when the defendant purchased 53,000 Geo shares. It appears that he also borrowed money from First Trust Bank to acquire a further large holding of Geo shares and according to the evidence he acquired 153,000 Geo shares through the First Trust loan.

6. Subsequently after a general fall in "hi-tech" share values the Bank became concerned about borrowings funding speculative share dealings and Head Office warned bank managers to watch out for borrowings on share dealings. In late September 1998 Mr Bennett became concerned about the fall in the value of the Geo shares in particular. The other shares providing security to the Bank had become worthless. Mr Bennett spoke to the defendant in October asking him to come into the Bank to discuss the way forward. At a meeting in October, according to Mr Bennett, the defendant agreed to deposit the 53,000 Geo shares by way of security. He also agreed to deposit a further 30,000 Geo shares out of the holding of shares that he had purchased with the benefit of the loan from First Trust Bank. According to Mr Bennett it was agreed that the memorandum of deposit would have to be updated to take account of the additional Geo shares being added by way of security. The defendant said that he would deposit the 30,000 shares from the First Trust holding as soon as he was able to obtain share certificates for 30,000 and his Geo shareholding held with First Trust Bank.

7. There was a conflict between the defendant and Mr Bennett as to what was discussed and agreed in October 1998. The defendant's case was that it was agreed that he would have until 31 March 1999 to clear his debt to the Bank. He said that he expected the share values in Geo to increase substantially by the end of March. He saw that it was understood that the Geo shares would not be sold before 31 March. The defendant's evidence was not consistent on these issues and he subsequently said that it was agreed that the Bank would not to sell the 30,000 Geo shares later provided as security when they were released by the First Trust Bank and that he agreed to lodge those further 30,000 shares in consideration of the extension to the end of March in respect of that holding of Geo shares. Mr Bennett was adamant that the Bank did not promise to hold back on any sale of the shares until 31 March 1999. He accepted that he would recommend to Head Office not to sell the shares before 31 March but he said that he made it clear that he did not have authority to bind the Bank not to sell before 31 March. It will be necessary later in this judgment to come to a determination on the disputed facts on this issue.

8. Mr Bennett arranged for a fresh memorandum of deposit to be prepared. Its material terms were in the Bank's standard form and the schedule was supposed to set out the details of the shares subject to the security. Mr Dempsey, a Bank official at the relevant Branch, prepared the schedule which included the 53,000 Geo shares which the defendant agreed to deposit. The schedule as initially prepared did not include any reference to the 30,000 Geo shares which the defendant promised he would lodge by way of additional security. In addition Mr Dempsey arranged for the preparation of blank transfer documents to be signed by the defendant which the Bank would be able to use to sell the secured shares in the event of it having to sell them to realise its security.

9. The defendant called into the Bank on 30 October 1998 and signed the new memorandum of deposit in the presence of Mr Dempsey and Miss Laverty, a control clerk in the Branch.

10. The blank transfer documents signed in relation to the Geo shares was in a form appropriate to a company participating in the CREST system of share transfers, a computerised system of share transfer. In this instance the use of that form at that stage was erroneous since Geo was not a party to the CREST system though subsequent to the relevant events of this case the company joined that system.

11. The Head Office of the Bank was very concerned about the financial risks facing it in respect of the defendant's debt position and it was decided to stop the accounts and on 28 November 1998 the Bank wrote letters stopping the various accounts and requiring immediate payment of the debts due thereon.

12. Following the sending of the November letters there was frequent contact between the defendant and Mr Bennett. The Bank's Head Office was pressing for action on the debt and considering bankruptcy proceedings against the defendant while Mr Bennett was trying to persuade the Head Office to hold off action.

13. The defendant went to the Bank on 18 January 1999 and handed over share certificates in respect of the 30,000 additional Geo shares which he had been able to extract from First Trust Bank. Subsequent to that the memorandum of deposit was altered to include a reference to those shares as part of the security. It will be necessary later in this judgment to consider the circumstances under which that alteration was carried out.

14. In the course of February 1999 Mr Bennett was seeking to persuade Head Office to hold its hand in relation to proceedings against the defendant. The view at Head Office was that the Bank would only forego bankruptcy proceedings on condition that the security was realised forthwith.

15. On 4 March 1999 the defendant was informed that his shares were to be sold. An acrimonious meeting took place at the Branch between Mr Bennett and the defendant. The defendant asserted that he would not have extricated the additional 30,000 Geo shares from the First Trust Bank and lodged them with the Bank if he had thought that the shares were going to be sold before 31 March. Another meeting took place on 8 March when the defendant was agitated and irate. Mr Bennett contacted Head Office and it was agreed to hold off the sale of the shares until 9 March when the company's annual report was due to be published. The defendant telephoned Mr Bennett on 9 March at 2.15 pm and informed the defendant that the shares would be sold unless the defendant came forward with concrete proposals. The shares were sold that afternoon, the deal being placed at 3.16 pm. The shares at that time were priced at 47p which yielded a total sum of £38,614.95 for the 83,000 shares which would have left the defendant still owing a considerable sum of money to the Bank.

16. Subsequent to that sale it was discovered that the blank transfer documents signed by the defendant which was needed to complete the transaction was in the wrong form. The settlement date for the transaction was 16 March. The defendant was asked to sign the correct transfer documentation but he refused to do so.

17. In order to fulfil its contractual obligations to the purchaser of the shares the Bank had to buy in 83,000 shares on the market to complete the deal at settlement date. By then the shares had increased in value and the price was 93p per share. The Bank was accordingly out of pocket in the sum of £38,575.05.

18. The Bank claims the undisputed debts due on Accounts A, B and C together with interest thereon are up-to-date and continuing and claims the sum of £38,575.05 for the loss it suffered in having to buy in the shares at the increased value.

The defendant's defence

19. While not contesting the Bank's claim for the principal sums due on Accounts A, B and C and interest thereon up to 31 March 1999 the defendant initially resisted the Bank's claim for £38,575.05 on the ground that the loss was at the Bank's own making. It had agreed not to sell the shares until 31 March and had it held back the sale of the shares to that date the sum realised would have cleared the debt and the Bank would have suffered no loss.

20. The defendant's case changed somewhat in the course of the trial and at the end of the day the defendant appeared to argue that the Bank was entitled to sell 53,000 Geo shares being the subject of the memorandum of deposit but it was not entitled to sell the 30,000 shares lodged in January 1999.

21. The defendant also relied on the rule in Pigot's Case to contend that the unilateral alteration of the memorandum of deposit by the addition of the 30,000 shares deposited with the Bank in January 1991 invalidated the whole memorandum of deposit and that the Bank had at best an equitable mortgage of the shares. Such an equitable mortgage, it was argued, would have required the Bank to apply to the court for an for sale of the shares before the shares could lawfully be sold.

Findings of fact in relation to the central issues

22. As noted the defendant has not presented a consistent case. In his pleaded case the defendant alleged that it was agreed that the defendant would have until 9 March 1999 to clear the overdrafts on the accounts. The defendant would use monies available to him to clear the overdraft on 31 March 1999 and no Geo shares were to be sold by the plaintiff. This was quite a different case from the case as put to the plaintiff's witnesses in cross-examination which again differed from the case as ultimately presented by the defendant when he was making the case that the Bank was entitled to sell the 53,000 Geo shares initially deposited by way of security

but was not entitled to sell the 30,000 shares from the First Trust Bank which the defendant had lodged by way of security on the basis that they would not be sold before 31 March 1999. Moreover, in his evidence the defendant asserted that he was at all times in funds available to discharge the debt due to the Bank, a proposition which if true renders his conduct inexplicable.

23. I am satisfied on the evidence of Mr Bennett that the defendant in October 1998 agreed to give the Bank a mortgage of his holding of 53,000 shares purchased with the aid of the Bank loan, that he would lodge by way of further security 30,000 shares out of his holding of Geo shares purchased with the aid of First Trust Bank funding, that he would enter into a memorandum of deposit and sign blank share transfer documents as part of the security, that he understood that the memorandum gave the Bank a power to sell the shares at any time prior to the discharge of the monies secured and that the defendant would do all things necessary to entitle the Bank to transfer the shares on foot of its power of sale and that the same terms and conditions would apply to the 30,000 shares when lodged as applied to the 53,000. I reject the defendant's case that Mr Bennett committed the Bank not to sell the shares before 31 March 1999. I do not accept his case that he lodged the 30,000 shares in consideration of a promise by the Bank that they would not be sold until 31 March. The defendant knew that the debts on the accounts had been called in on November 1998 and that the Bank was pressing urgently for the repayment of the debts. He had promised in October 1998 to lodge the 30,000 shares as part of his security and the Bank had held its hand in enforcing its right to recover the debt.

The alteration of the memorandum of deposit

24. The alteration of the document was effected by Miss Laverty, the control clerk who was asked by Mr Bennett to arrange for the alteration to be made following the lodgment of the 30,000 shares by the defendant in January 1999. Her evidence was that she thought she altered the schedule as soon as Mr Bennett asked her to do so. She thought that she had then tried to contact the defendant later that day to come in to initial the alteration but she was not sure that she had done so. The defendant denied any knowledge of the change in the document. I accept his evidence on this point and I am satisfied the defendant was unilaterally altered by the Bank. The effect of that alteration requires a consideration of the law in Pigot's Case.

25. In Pigot's Case (1614) 11 Co. Rep. 26B at 27A Lord Coke stated the law in these terms:

> *"When any deed is altered in a point material by the plaintiff himself, or by any stranger, without the privity of the obligee, be it by interlineation, addition, erasing or by drawing of a pen through a line, or through the midst of any material word, ... the deed thereby becomes void ... so if the obligee himself alters the deed by any of the said ways, although it is in words not material, yet the deed is void: ... if a stranger, without his privity alters the deed by any of the said ways in any point not material, it shall not avoid the deed."*

26. The rationale for the rule was apparently twofold. First, the effect of the alteration renders the deed or instrument sued on no longer the deed or instrument of the party charged. Secondly, the rule was designed to prevent fraud (see Master v Millar (1791) 4 Term Rep 320).

27. The decision in Pigot's Case can be summed up as follows:

    (i) A deed becomes void if it is altered in any way by the obligee.

    (ii) A deed becomes void if it is altered in a material way by a stranger to the transaction.

    (iii) A deed does not become void if it is altered in a way that is not material by a stranger to the transaction.

28. The decision modified a harsher earlier line of authority exemplified by Elliott v Hulder. In that case it was held that any alteration of a deed made it utterly void whether the alteration was in a material place or not.

29. Although the rule in Pigot's Case was originally closely related to the plea of non est factum and was really an aspect of it, in modern times it has been regarded as a separate defence. At common law an obligor could plead non est factum if a deed was lost, destroyed or altered. Equity came to grant equitable relief when the deed was lost or destroyed but did not grant relief in cases of alteration. It cannot be said that this is entirely logical.

30. The rule in Pigot's Case came to be extended not only to deeds but to other written contracts (see Master v Millar (1791) 14 Term Rep 320).

31. In its original form the rule established that a deed became void if it was altered in any way by a party in whose custody the document was. In Aldous's case (1868) LR 3 QB 753 it was held that any immaterial alteration made by or with the authority of the person in whose custody the document is did not render the deed void.

32. In general it seems clear that the touchstone of materiality has been whether or not there has been some alteration in the legal effect of the contract or instrument concerned simply in the sense of some alteration in the rights and obligations of the parties. Those cases in which the alteration or obliteration have been held to be immaterial have been cases of two kinds. First, those where either it was or could have been said that the alteration has rendered express or added nothing to what the law would otherwise provide or imply. Second, there is the case where the alteration corrects a "mere mis-description" which can be cured by parol evidence that a person or entity referred to has been mis-described and the alteration merely corrects the error. In the Irish case of Caldwell v Parker (1869) Irish Reports 3 Equity 519 the Master of the Rolls for Ireland observed that "material" in this context meant "having an effect on some contract or right contained in or arising out of the instrument itself".

33. In Raiffeisenzentralbank Österreich A G v Crossseas Shipping [2000] 3 All ER 274 S executed a guarantee in favour of the claimant bank. One of the clauses which contained spaces for details of S's service agent was left blank but was later filled in by the bank without S's knowledge. The bank subsequently demanded payment under the guarantee and sent formal letters of demand to S in Kenya and to the service agent in England. Shortly afterwards it launched against S proceedings to enforce the bank's rights and obligations. S contended that the alteration had changed the bank's rights and obligations in respect of the service of demands and legal proceedings and that accordingly the change was a material one rendering the guarantee enforceable. On the trial of the preliminary issues the judge held inter alia that the service agent clause was procedural in nature and the alteration made no difference to the operation of the guarantee or to its business effect. It followed that the guarantee was enforceable. The Court of Appeal upheld the ruling. The court held that the parties seeking to avoid the contract had to demonstrate that the alteration was one which was potentially prejudicial to its legal rights or obligations. Without an element of potential prejudice no inference of fraud or improper motive was appropriate. The service agent clause did not alter or accelerate S's liability to make the payment under the guarantee. On the facts potential prejudice to S could only arise if he sought to evade service of proceedings against him personally in respect of the guarantee.

34. Potter LJ concluded:

> *"In the light of the conflict apparent on the authorities … to take advantage of the rule, the would-be avoider should be able to demonstrate that the alteration is one which assuming the parties act in accordance with the other terms of the contract is one which is potentially prejudicial to his legal rights and obligations under the instrument."*

35. In the opinion of some the question of intention is relevant to the issue of materiality. In British Columbia, Queensland and South Australia the courts have argued that the presence or absence of fraud is an indication of materiality while the English authorities suggest that motive is irrelevant. In most of the jurisdictions in the United States the operation of the rule depends on fraudulent intent. This approach has been adopted in the American Re-statement of the Law of Contract which states that the alteration must be both fraudulent and material for an agreement to be discharged. The Canadian courts have rejected the rule. In the United States the making of alterations by strangers without the knowledge or consent of the promisee is referred to as "spoliation" and has no effect on the instrument. Both the New Zealand Law Commission and the Law Reform Commission of New South Wales have recommended the abolition of the rule in Pigot's Case and a statutory declaration that a material alteration to a deed or written contract or any document evidencing a contractual intention does not by itself invalidate the deed or render it voidable or otherwise affect any obligation under the deed.

36. What does appear clear from the authorities is that "this primitive and arbitrary rule should be confined as closely as respect for the doctrine of precedent will admit" (per Brey CJ in Armor Coatings (Marketing) Property Limited v General Credits (Finance) Property Limited [1976] 17 SASR 259 at 282 (a view with which the Court of Appeal in Raiffeisen agreed (see Potter LJ at 286) F-G).

37. Mr Devlin argued that the incorporation of the amendment in the schedule did not in any material way prejudice or act to the detriment of the defendant. Having deposited the 53,000 shares at the Bank on the basis that he would enter into a memorandum of deposit incorporating Bank's standard terms and having agreed to deposit 30,000 Geo shares on the same basis the defendant had conferred on the Bank an equitable mortgage over the shares. If the memorandum were treated as void that would not detract from the Bank's security arising from the deposit of the shares. The defendant having agreed to deposit the 30,000 shares on the same terms and conditions as the 53,000 shares (being the terms and conditions set out in the memorandum) he would have been bound to give to the Bank the same security which it had over the 53,000 shares. Equity looks on as done that which ought to be done.

Nature of the Bank's security

38. A mortgage of shares may be a legal or an equitable mortgage. A legal mortgage is effected by a transfer of the shares by the mortgagor subject to an agreement for their retransfer on payment of the loan. Such a legal mortgage is not usual and it is more common for an equitable mortgage of shares to be created. As pointed out in Fisher & Lightwood, 10th Edition on Mortgages at page 222 commonly a mortgage of shares is effected by the deposit of the share certificates often accompanied by a memorandum of deposit containing a statement that the deposit is by way of security, a covenant for payment of the principal and interests with a proviso for redemption, a power to sell the shares and an obligation to execute a transfer to any purchaser from the mortgagee.

39. In this case the memorandum contained in Clause 1 the following provision:

> *"At any time or times hereafter prior to the discharge of all the monies hereby secured I or my successors in title will upon demand and at my or their own expense execute and do all such transfers, assurances and things for assuring and vesting the full legal title to the mortgaged securities or any of them to and in the Bank or any purchaser or purchases from them under an exercise of the power of sale herein contained as may by them or him be reasonably required."*

Clause 4 provided:

> *"It shall be lawful for the Bank at any time thereafter during the continuance of the security without any notice to or any further consent or concurrence by the mortgagor to sell the mortgage securities or any of them in such manner and upon such terms and conditions generally as they shall think fit and to apply the net proceeds of any such sale in or towards the discharge of the monies thereby secured."*

40. As pointed out in Fisher & Lightwood a deposit is often accompanied by a form of blank transfers signed by the mortgagor. Here the defendant signed a blank transfer which was not in the correct form. It could thus not be used for the purpose of perfecting a transfer of the shares. However, the defendant's obligations under the memorandum required the defendant to sign any necessary documents to effect a transfer where the Bank exercises its power of sale. It is an incident of a mortgage of chattels and choses in action that the mortgagee has a power of sale exercisable if the defendant fails to pay the monies due on the day fixed for payment or where no day is fixed after a proper demand and notice has been given and a reasonable time has elapsed (see Deverges v Sandeman [1902] 1 Ch 579).

41. Here the defendant created a good equitable mortgage of the 53,000 shares and was bound to enable a sale to be completed when the Bank exercised its power of sale. He deposited the 30,000 additional shares on the basis that they would be part of the same security to be held on the same terms. The alteration of the memorandum, accordingly, rendered express what was already agreed between the parties. If it had been necessary to require the defendant to join in the alteration of the document an order for specific performance would have been issued. Equity looks on as done that which ought to be done. Accordingly I accept Mr Devlin's argument that the alteration of the deed by the Bank did not materially affect or prejudice the rights of the defendant and thus the alteration did not avoid the deed.

Conclusion

42. In the result I am satisfied that the Bank is entitled to judgment for the principal sum due on Accounts A, B and C and is entitled to interest thereon at the contractual rate up until judgment. With interest to today, 1 June 2001, Account A amounts to £683.91, Account B to £90,641.85 and Account C to £5,218.39. I am also satisfied that the Bank is entitled to damages in the sum of £38,575.05. The Bank will be entitled to charge interest at the contractual rates referred to at paragraph 3 above on the principal sums due until payment. I award interest at 8% on the sum of £38,575.05 from 16 March 1999 to date. The judgment debt of £38,575.05 will attract judgment rate interest from today's date.

43. It is noteworthy that the Geo shares achieved a price of £36 per share on 16 March 2000 while the present litigation was ongoing. Had the relevant shares been sold at that time they would have been worth in excess of £2.7m. As it is the shares have fallen considerably in value since then. At the date of the hearing the shares were worth £3.75. They still represent more than adequate security for the Bank and it is in the interests of the defendant to co-operate in the sale of those shares. The defendant is bound to join in any necessary documentation to enable the sale to be effected and in the absence of agreement it would be open to the Bank to

apply for a mandatory order to require him to sign the necessary documentation. As the shares are clearly volatile it is in the interests of all parties that the sale of the shares to discharge the debt should take place as quickly as possible.

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JUDGMENT

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