SHEEHAN v ABEYRATNE (as trustee of the deed of arrangement of SHEEHAN) - BC9304783

Federal Court of Australia -- Bankruptcy District of Victoria -- General Division
Einfeld J

VX205 of 1991

30 April 1993

BANKRUPTCY -- application by liquidator for invalidation of Part X deed of arrangement -- guarantee by debtor of liability of third party mortgagor -- mortgagor's liability doubtful or not proved -- liquidator not permitted to vote although claiming to be a creditor -- unascertained or doubtful debt -- time for determining status of debt -- inadequate documentation and particularisation of debt -- duty of chairman -- role of court -- whether demand is a precondition of liability.

(CTH) Bankruptcy Act 1966 ss 5, 198(2), 198(4), 201, 222(1), 222(2), 236(1), 236(2), 236(3)

(VIC) Building Societies Act 1986 s 57

(CTH) O'Donovan and Phillips, The Modern Contract of Guarantee (Law Book Co 1985)

Re Brewer Ex Parte Eurodollar Pty Ltd Einfeld J unreported 26 August 1992; *Re Peters Ex Parte NZI Securities Ltd* Full court of Federal Court (Northrop, Spender, Burchett JJ), unreported 16 October 1992; *Re Segal* (1975) 9 ALR 154; *Re Venetoulis* (1976) 13 ALR 625; *Beard v Prestige Baking Industries* (1981) 36 ALR 307; *Sunbird Plaza Pty Ltd v Maloney* (1987-88) 77 ALR 205; *Musolino v Sidiropoulos* (1991) 101 ALR 235; *Forshaw v Thompson* (1992) 106 ALR 633; *Re McLean; Ex parte Friends Provident Life Office* (1992) 108 ALR 360; *Re Levy & Ors; Ex parte Scholefield Goodman & Sons Ltd & Ors* (1980) 50 FLR 99; *; Ex parte Ruffie* (1873) LR 8 Ch App 997; *Lep Air Services Ltd v Rolloswin Investments Ltd (reported as Moschi v Lep Air Services Ltd)* (1973) AC 331

Einfeld J.

By amended application dated 12 August 1992, the liquidator of Farrow Mortgage Services Pty Ltd (Farrow) seeks an order under s 222(1) or 236(1)(c) of the Bankruptcy Act (the Act) declaring void a deed of arrangement accepted by the creditors of Gavin Francis Sheehan (the debtor) at a meeting on 2 July 1991. The application is opposed by the debtor but the trustee of the deed who is the first respondent to the application and was the chairman of the meeting submits to any order the court sees fit to make. The grounds of the application are that the liquidator was not permitted to vote at the meeting although Farrow was a creditor. The meeting had been earlier adjourned from 18 June 1991 to 2 July to enable the first respondent to inquire into and rule on the liquidator's right to vote. Upon the invalidation of the deed, a sequestration order is sought pursuant to ss 222(7) or 236(3). The essential feature of the deed for present purposes is that it requires the debtor to pay the trustee the sum of $30,000 by monthly instalments of $1,000 commencing on 1 August 1991. Very little of the $30,000 has apparently been paid.

Sections 222(1) and (2) and 236(1) and (2) state as follows:

222(1) Where there is a doubt, on a specific ground, whether a deed of assignment or a deed of arrangement was entered into in accordance with this Part or complies with the requirements of this Part, or whether a composition has been accepted by a special resolution of a meeting of creditors under s 204, the Inspector-General, a person authorised in writing by the Inspector-General, the Registrar, the trustee, a creditor or the debtor may apply to the court for an order under subs (2).

(2) Upon the hearing of an application made under subs (1), the court may, subject to this section, make an order:

(a) declaring that the deed or composition is void, or that it is not void, on the ground specified in the application; or
(b) declaring that a provision of the deed is void, or is not void, on the ground specified in the application.

236(1) The court may, upon application by the trustee, a creditor or the debtor, or, if the debtor has died, the person administering the estate of the debtor, if it is satisfied:
(a) that the debtor, or, if the debtor has died, the debtor or the person administering the estate of the debtor has failed to carry out or comply with a provision of the deed of arrangement;
(b) that the deed of arrangement cannot be proceeded with without injustice or undue delay to the creditors, the debtor or, if the debtor has died, the estate of the debtor; or
(c) that for any other reason the deed of arrangement ought to be terminated;

make an order terminating the deed.

(2) The court shall not make an order terminating a deed on the ground specified in para (1)(a) or (c) unless it is satisfied that it would be in the interests of the creditors to do so.

In the terms of these provisions, this case raises issues concerning whether the deed's entry or content accords or complies with the Act or whether for any other reason the deed ought to be terminated.

The basic facts, seemingly not in dispute, are as follows:

1 On 3 February 1987 Farrow by its then name advanced the sum of $930,000 to Janthol Pty Ltd, a company of which the debtor was a director.
2 The advance was secured by way of a first mortgage (the Manboo mortgage) over real property at Trentham Rd, Kyneton, the registered proprietor of which was a company known as Manboo Pty Ltd (the Manboo property). The debtor was also a director of Manboo.
3 Debenture charges were taken over the assets and undertakings of Janthol and Manboo as security for the advance. The securities purported to be cross linked or collateralised so that a default by Janthol was supposed to become a default by Manboo.
4 Manboo's liability also purported to be guaranteed by the debtor and his wife, Sharon Ann Sheehan. The guarantee sought to link the debtor to any default of Janthol via a default by Manboo under the security documents.

On 23 September 1987 the amount of the advance was increased by a further loan to Janthol of $150,000. This is said to have involved inter alia a variation of the Manboo mortgage and of the mortgage debentures, and a second guarantee given by the debtor.

On 5 May 1989 another $250,000 was advanced to Janthol. The security for this further variation purportedly included variations of the mortgage debentures over Janthol and Manboo, variations of the Manboo mortgage and a third guarantee by the debtor.

The advance was frequently in arrears and on 28 May 1991 a demand by Farrow for $1,838,821.31 was served on Mr G F Sheehan, c/- 357-359 359 King St, Melbourne (the registered office of Manboo) and on G F Sheehan, c/- Trentham Rd, Kyneton and at 238 The Ave, Parkville. The debtor disputed service but accepted at the hearing that the rules as to service had been complied with and that he is therefore deemed to have been served with the demand.

Demand was also served on Janthol and Manboo on the same date, presumably for the same amount.

Farrow entered into possession of the Manboo property in May 1991.

On 15 May 1991 the debtor signed an authority to the first respondent under s 188 of the Act to take control of his property and call a meeting of creditors.

On 11 June 1991 Farrow became aware that the debtor had signed the section 188 authority and that a meeting of creditors would be held on 18 June 1991 to consider a Part X arrangement for his creditors.

On 14 June 1991 Carmel Doyle, a solicitor then with Molomby and Molomby representing Farrow and the liquidator, notified Craig Lawrence of Pannell Kerr Forster, of which firm the first respondent was a partner, of the interest of Farrow in the proposed Part X arrangement by virtue of the guarantee and of its intention to be represented and seek to vote at the creditors' meeting.

Between 14 and 18 June 1991, the first respondent supplied Doyle with the basic documentation for the Part X meeting and sought particulars of the alleged debt to Farrow. He indicated that he was prepared to adjourn the meeting to 2 July 1991 to enable Farrow to particularise and substantiate its claim to be a creditor.

By letter of 21 June 1991, the first respondent sought further particulars of the debt and permission to interview the person who had valued the relevant securities for Farrow. Copies of the following documents were provided at the resumed meeting:

(i) the loan account of Janthol's indebtedness to Farrow;
(ii) the Manboo mortgage;
(iii) one of the debtor's guarantees;
(iv) a valuation of the securities covered by the Manboo mortgage on a strictly confidential basis; and
(v) the demand on the debtor for $1,838,821.31 Farrow declined to supply other material sought and did not give permission to speak to the valuers. The liquidator indicated that he only wished to vote in the sum of $730,624.95, being the difference between the sum demanded plus interest to 2 July 1991 and the valuation of the Manboo property.

At the resumed meeting the first respondent stated that he did not have sufficient information to accept Farrow as a creditor at all and could not adjourn the meeting again without a resolution of the creditors. He ruled that Farrow was not entitled to vote.

The deed was accepted by the meeting by special resolution. It would not have been passed if Farrow had been permitted to vote for the amount claimed.

In August 1991 the debtor commenced to pay the instalments as contemplated by the deed of arrangement but he has not fully complied with his obligations under it.

17.In March 1992 Farrow sold the Manboo property for $920,000. This price meant a shortfall under the guarantee in excess of the amount for which Farrow sought to be admitted to vote at the Part X meeting.

18 The original application in the present proceedings was issued on 10 July 1992 and served that evening on the respondents. It was amended on 12 August 1992.
19 It seemed also to be common ground that Farrow was not a secured creditor within s 5 of the Act, as there was no security over the property "of the debtor" for a debt to Farrow from the debtor.
5 In view of matters which arose at the hearing, the debtor was given leave to amend his notice of opposition to the application. This was filed on 4 March 1993, after the hearing. Apart from general denials and joinder of issue, its fundamentals are:
1 The liquidator was not entitled to vote because he had not given the chairman of the meeting particulars of the debt claimed: s

198(4).

2 Because of the liquidator's delay in supplying proper particulars of the claimed debt, the chairman had no power to adjourn the meeting any further to enable him to investigate the claimed right to vote: s 201.
3 As Farrow had not realised its security and therefore the unsecured balance of the debt after realisation had not been ascertained, the liquidator was prevented from voting: s 198(2).
4 There was no debt because:
(a) the loan from Farrow was in breach of s 57 of the Building Societies Act 1986 (Vic) and was therefore illegal;
(b) the debt arose out of a guarantee by the debtor of a mortgage when in fact the relevant security was only a deed of variation of the mortgage;
(c) the relevant guarantee merged in and was extinguished by a later guarantee, or no demand was made under the relevant guarantee;

(d) neither the guarantee nor the Manboo mortgage founds the claimed debt nor was any money able to be demanded under the guarantee because at best any debt was unliquidated, contingent or unascertained.

5 Even if there was a debt, the court should in its discretion not declare the deed void due to the "inordinate, unexplained and inexcusable delay" which has attended the presentation of the application.

6 This document produced very recently a new set of written submissions on behalf of the applicants. Together with all that had gone before, at and following the hearing, these enable the case to be conveniently discussed under a number of headings. It is not necessary, and the case is not an appropriate vehicle, to consider the illegality argument raised by the debtor.

1 Time for determining status of debt

7 On the basis of a decision of Justice Heerey Re McLean Ex Parte Friends Provident Life Office (1992) 108 ALR 360, the applicants argued that the time for the court to determine the status of the alleged debt is the hearing of this case not the meeting. Accordingly they foreshadowed entering into evidence a certificate from a duly authorised officer of Farrow or of the liquidator setting out the debt due under the mortgage at both times. A document of this kind was marked for identification but it was inadequate or not properly authorised, and in the end no such document was evidenced at the hearing. However, there was annexed to the new submissions of the applicants of 15 April 1993 a certificate dated 16 March 1993 certifying that the amount owing was:

On 28 May 1991 $1,838,821.37 On 2 July 1991 $1,880,694.68 On 2 March 1993 $1,360,722.12

8 It is not clear to me that this certificate is admissible in evidence but the matter is largely moot because of the fact, as conceded at the hearing on behalf of the debtor, that if all his other arguments fail, he was in debt to Farrow under the guarantee. It was not a major concession as the debtor's statement of affairs to the Part X meeting acknowledged a "potential shortfall on loan from Farrow ... ".

9 Justice Heerey's view in McLean was that the question at a creditor's meeting is whether the disputed debt is owing. In discussing the court's function under s 222(1) and the decision of a Full court of the court (Black CJ, Sweeney and Lockhart JJ) in Forshaw v Thompson (1992) 106 ALR 633 that the court has power under the Act to determine questions concerning rights to vote at Part X meetings, Justice Heerey asked whether the court's task was to review the correctness of the chairman's decision or to consider the matter afresh. At 368 his Honour's conclusion was that:

... the weight of authority is now in favour of the view that the court looks at the evidence presented to it at the time of the application ... (citing Re Tregonning (1983) 74 FLR 327 and Zantiotis v Andrew (No 2) (1988) 80 ALR 299)

10 Aspects of McLean were cited with approval by a Full court of this court (Northrop, Spender and Burchett JJ) Re Peters Ex Parte NZI Securities Ltd unreported 16 October 1992 but this matter was not specifically considered. Farrow did not argue here that the chairman should have again adjourned the meeting on 2 July to permit further investigations of its claimed debt and right to vote.

2 Duty of Chairman; Role of court

11 Section 201 states:

Any question as to the right of a person to vote at a meeting under this Division, or as to the amount of the debt in respect of which a person is entitled to vote at such a meeting, shall be determined by the chairman, who may, if he thinks it necessary to do so, adjourn the meeting for a period, not exceeding 14 days, to enable him to investigate the matter.

12 Farrow submitted that the failure of a creditor to raise a "question" means that the section is not activated. In Re Venetoulis (1976) 13 ALR 625, Riley J said at 631:

What s 201 requires the chairman to determine is not the right of a person to vote (or the relevant amount of a person's debt) but any question as to that right (or amount); and there is no evidence that any such question was raised.

13 However, the section is not as narrowly framed as Farrow suggested. It now seems well settled that a chairman has to satisfy himself, not so much the creditors, that each claim to be a creditor is justified. To determine these claims requires the chairman's acceptance or rejection, in a fairly summary way, of the

proofs of debt submitted, including any that were disputed. As Bowen CJ said Re Levy and Ors Ex parte Scholefield Goodman and Sons Ltd and Ors (1980) 50 FLR 99 at 112:

Section 201 is designed to empower the Chairman not to make a final ruling on a debt -- that is for the trustee who will decide whether it is provable -- but to rule for the purposes of the meeting in a summary way avoiding technicalities and delays ... His decision is not made appealable by the Act ... The policy revealed by s 201, particularly when read with s 225(2), appears to be to facilitate the efficient and final despatch of business in relation to a meeting of creditors under Part X.

The judgment proceeded:

On the other hand, s 201 does not expressly make the chairman's decision final and conclusive. No doubt if the court was seized of another matter in the course of which it was material to determine whether or not a person was a creditor entitled to vote at the meeting, the court would be able, indeed would be obliged, to determine the question, in order to exercise its jurisdiction effectively and would not be bound by the chairman's decision: see s 30(1).

14 Forshaw held that on its true construction, s 201 delegates to the chairman of a Part X meeting, and no one else, the right and obligation to determine questions as to voting rights at the meeting. As voting rights are determined by reference to the existence and amount of creditors' debts, this means that the chairman must also make determinations on such matters. But, as Bowen CJ said in Levy, these are not definitive final conclusions on the admission or amounts of the debts. Justice Lockhart, with whose reasons for judgment Chief Justice Black and Justice Sweeney agreed, said in Forshaw at 642:

The determination of the right of a creditor to vote may involve the consideration of a variety of circumstances including, as here, the question whether the creditor is a contingent creditor and therefore disqualified from voting by s 198(2) or whether he is a creditor at all (also this case). The determination of these questions is certainly open to the chairman for the purposes of determining entitlement to vote at meetings, but his examination must necessarily be limited and not binding upon anybody otherwise than with respect to the entitlement to vote at the relevant meeting; he cannot determine substantive rights and liabilities involving the relationship of debtor and creditor.

15 His Honour went on to observe that while s 201 "both empowers and requires" the chairman to rule or decide in this regard, it does not oust the power of the court to intervene in or review a decision in a particular case. The criteria for intervention were not specified but the observations of Bowen CJ in Levy in this respect were apparently approved.

16 It is not entirely clear how Justice Heerey's observations in McLean sit with these principles or indeed how far the principles extend when the court is asked to review the chairman's decision. Perhaps it is that the court will deal with the matter as it believes the chairman should have done on the basis of all the material before it regardless of whether that material was made available to the chairman at the meeting.

3 Unliquidated, contingent or unascertained debt

Section 198 provides:

(1) Subject to this section, every creditor is entitled to vote at a meeting under this Division.
(2) A creditor is not entitled to vote in respect of an unliquidated or contingent debt or a debt the value of which is not ascertained.
(3) For the purpose of enabling a creditor to vote, a debt that is certain but is payable in the future shall be deemed to be payable at the time of the meeting.
(4) A creditor is not entitled to vote (otherwise than in respect of the election of a chairman of the meeting), unless he has made known to the chairman particulars of his debt.
(5) Except as provided by subs (6), a secured creditor is not entitled to vote in respect of a secured debt unless he surrenders his security.
(6) A secured creditor may, if he has furnished to the chairman, in writing, particulars of the security and of the value at which he estimates it, vote in respect of the balance (if any) of the secured debt after deducting the value at which he has estimated the security.
(7) The spouse, or the de facto spouse, of the debtor is not entitled to vote at a meeting under this division.

The applicants argued that once a demand was made under the guarantee, the amount of the indebtedness was fixed and ascertained. The fact that $1.838 million, which included an element of unpaid interest, was demanded but Farrow only

sought to vote on 2 July 1991 for what was left of this sum as it had then become with further interest ($1.88m approximately) after deducting the valuation of the secured mortgage did not qualify or derogate from the ascertained debt. In fact it was stated that if that deduction had not been made, Farrow would have been unjustly enriched.

The debtor said that the debt was at best unascertained. On the morning of the resumed meeting, the first respondent was supplied with a valuation that the Manboo property would realise "in the range of $1,050,000 to $1,150,000" on sale. Farrow subtracted the higher of those two figures from the amount claimed in the demand plus interest in calculating the "shortfall" it wished to vote for. The debtor argued that as the only mortgage evidenced secures $930,000, and that that sum is less than the lower valuation, there was no shortfall at all on the documentation supplied to the first respondent as chairman of the Part X meeting.

The loan account with which the first respondent was also supplied showed some credits. The debtor argued that it was simply not possible for the chairman to have known against what amounts such credits were to be applied and whether they were payments of principal or interest. I was not able to be told at the hearing either. Thus the debtor said that Farrow did not make known to the chairman full or adequate particulars of its debt not only at either of the sessions of the meeting but in answer to his letter of 21 June 1991 seeking documentary support. By s 198(4) it was thus not entitled to vote.

Riley J said in Venetoulis at 629:

The statute does not state what are the particulars that must be made known to the chairman. They obviously include the amount of the debt. It may be deduced that they include also sufficient information to enable the chairman to determine whether the debt is 'an unliquidated or contingent debt or a debt the value of which is not ascertained' ... ;

particulars of the security, if any ... ; and, if a question arises for determination under s 201, all such information as may be required to enable the chairman to determine that question.

Justice Heerey in McLean questioned whether it was sufficient for a creditor to establish an arguable case for the debt, but after reviewing authority concluded at 369 that:

... it will usually be appropriate for a court to make a finding as to the existence and extent of the alleged debt and not merely whether there is an arguable case.

In Beard v Prestige Baking Industries (1981) 36 ALR 307 Fox J, with whom Justice Sheppard appears to have agreed, said at 325:

It is undoubtedly competent for the court to examine in close detail, definitively if necessary, whether a person claiming to be a creditor for the purposes of the section is one ...

Justice Lockhart, who dissented in the result, said that it may be sufficient if a creditor can show a prima facie case of debt, or a "genuine claim" to be a creditor ... or a claim which is "proper and reasonable to litigate". His Honour rejected the proposition that it was sufficient for a creditor merely to assert a debt.

In Levy, Bowen CJ at 111-2 considered that a debt is certain "if it is capable of being rendered certain". The context suggests that he meant capable of being rendered certain by existing facts rather than by events yet to occur. Mellish J said in Ex Parte Ruffie (1873) LR 8 Ch App 997 at 1001 that ... a debt, the value of which is not ascertained, means a debt the amount of which cannot be estimated until the happening of some future event.

In Re Segal (1975) 9 ALR 154 at 160, Riley J approved Ruffie and stated that an estimate by the creditor is insufficient. On the other hand, I accept Farrow's submission that a chairman may determine that a creditor be accepted and given a right to vote in respect of a minimum debt which the chairman estimates in the least specific sum proved to his satisfaction.

4 The Manboo mortgage

As pointed out by Farrow to the first respondent on 14 June 1991 just prior to the first meeting, Manboo had given a freehold mortgage to Farrow purporting to secure moneys owed by Janthol to Farrow. In the Manboo mortgage the debtor is Janthol, the mortgagor is Manboo and the mortgagee is Farrow (by its earlier name). Clause 1 of the Manboo mortgage states:

That the Debtor will pay to the Mortgagee the moneys secured (which expression is defined in cl 38) at the expiration of six months from the date hereof AND IT IS FURTHER AGREED that if the Mortgagor and the Debtor shall observe

and perform all the covenants and agreements contained in this Mortgage then the Mortgagee will not call up the moneys secured or any part thereof before the day immediately prior to the third anniversary of the date upon which the advance or any part thereof is first made.

Clause 2(1) states:

The Debtor shall pay to the Mortgagee interest upon the moneys secured or so much thereof as shall from time to time be outstanding with the rests (if any) set out in the Schedule at the higher rate set out in the Schedule, provided that if the interest payable is paid on the due date for payment thereof or within seven days thereafter and the Debtor or the Mortgagor is not otherwise in default hereunder the Mortgagee shall accept interest computed at the lower rate set out in the Schedule in lieu of interest at the higher rate but without prejudice to the right of the Mortgagee to require payment of interest at the higher rate for any period in respect of which any interest due has not been paid upon the due date for payment thereof or within seven days thereafter. Such interest shall be computed from the commencing date set out in the Schedule and shall be payable as set out in the Schedule.

Clause 16 states:

The Mortgagor and the Debtor will duly and punctually pay the cost of all sewerage connections and fittings and all rates taxes duties assessments and outgoings of every description now or hereafter payable or charged or chargeable upon or in respect of the land or any part thereof or upon the owner or occupier or the Mortgagee in respect thereof and will on demand produce to the Mortgagee the receipt for every such payment.

Clause 18 states:

If the Debtor make default in payment of any interest hereinbefore covenanted to be paid to the Mortgagee and if such default continue for more than seven days after the date hereinbefore appointed for such payment or if the Debtor or the Mortgagor makes default in the payment of any other money or in the performance or observance of any other covenant or agreement herein contained or herein implied by the Act to be performed or observed by the Debtor or the Mortgagor or if the Debtor or the Mortgagor being a company go into liquidation then and in each such case the moneys secured shall at the option of the Mortgagee become immediately due and payable.

The "moneys secured" are defined in cl 38 as:

(i) the advance;
(ii) any further advances made by the Mortgagee to the Mortgagor; and (iii) all other moneys payable by the Mortgagor to the Mortgagee pursuant to this Mortgage.

The debtor argued that apart from cl 22 which requires the mortgagor to insure buildings and fences on the subject land, the mortgage does not require Manboo to do or pay anything, let alone repay the loan to Janthol by Farrow in the event of default by Janthol.

Interestingly, apparently because the land was old system land, the mortgagor actually conveyed the land to the mortgagee in consideration of the loan to the debtor. It was thus submitted that this does not even obligate Janthol to pay the moneys advanced. It is not a matter I am called upon to decide but certainly the preamble and cl 1 in combination do not state the obligations of Janthol entirely clearly. The debtor's principal submission was that there was nothing undertaken by Manboo for him to guarantee.

4 The guarantees

There were three guarantee documents, respectively dated 3 February 1987 (No 1), 23 September 1987 (No 2) and 5 May 1989 (No 3). The three guarantees are in substantially identical form. Their introduction and cll 1 and 2 state:

The Guarantor(s) described in the Schedule hereto (hereinafter referred to as "the Guarantor") in consideration of the Mortgagee described in the Schedule hereto (hereinafter referred to as "the Mortgagee") at the request of the Guarantor having agreed to make the advance referred to in the Mortgage (hereinafter called "the Mortgage") bearing the date in the Schedule from the Mortgagor referred to in the Sch (hereinafter called "the Mortgagor") to the Mortgagee of the land described in the Schedule HEREBY COVENANT(S) AND AGREE(S) with the Mortgagee as follows:

1 THE Guarantor guarantees to the Mortgagee the payment of the moneys secured as defined in the Mortgage and payable by the Mortgagor and the performance and observance of all covenants

obligations terms and conditions contained or implied in the Mortgage and on the part of the Mortgagor to be performed or observed.

2 If any of the obligations hereby guaranteed are not enforceable against the Mortgagor this Guarantee shall be construed as an indemnity and the Guarantor hereby indemnifies the Mortgagee in respect of any failure by the Mortgagor to make any payment or perform or observe any covenant obligation term of condition referred to in cl 1 of this Guarantee.

The Manboo mortgage was the mortgage scheduled to No 1. The debtor's first submission was that each guarantee rescinded and replaced the earlier one, and that the only relevant one for present purposes is therefore No 3. This is supported by the fact that the debt on which Farrow claimed the disputed right to vote is that contained in a demand dated 28 May 1991 (the demand) which refers only to No 3. No demand was ever made under No 1 or seemingly, so far as the evidence is concerned, No 2.

On the other hand, cl 4 of all the guarantees states:

The Guarantee is independent of and in addition to any other guarantee or security held or to be held by the Mortgagee for all or any of the indebtedness or liability of the Mortgagor and the Guarantor shall not in any way or at any time claim the benefit or seek or require the transfer of any such guarantee or security or any part thereof.

Farrow argued that this provision disposes of the "merger" argument. If so, it does not disavow the proposition that only No 3 is presently relevant. As mentioned earlier, the applicants relied on the demand as fixing and ascertaining the amount of the debt. They also supplied the demand to the first respondent as a particular of the debt.

Because of cl 38 of the Manboo mortgage, there is an initial problem with the guarantees because the moneys secured were advanced by the mortgagee (Farrow) to the debtor (Janthol), not the mortgagor (Manboo). Nor is there evidence of any moneys payable by the mortgagor to the mortgagee at all, even such as rates, water and sewerage, or insurance. Thus there were no moneys for the debtor to guarantee. This anomaly may perhaps be covered by the clause 11, added to the guarantee forms by typing, stating:

Where a Debtor is named in the schedule to the mortgage the words "Mortgagor or the Debtor" shall be substituted for the word "Mortgagor" wherever it appears in cll 1 to 10 hereof and a reference herein to "the Debtor" shall mean the Debtor named in the Schedule to the Mortgage.

although this clause is somewhat confusing and it is not easy to know what its effect is.

No 1 correctly identifies the mortgage concerned as that of 3 February 1987. Thus the debtor said that at most it could only require the payment of the original advance of $930,000. No 2 identifies the same mortgage. The only other document in evidence in relation to No 2 is Memorial Book 858 No 887 which purports to extract the basic details of a registered instrument dated 23 September 1987 called a Deed of Variation of Mortgage dated 3 February 1987 to secure $930,000 to which it is said to be "supplimental" (sic). It is impossible to know from this evidence whether there was in fact a further charge on the property giving rise to any obligation on Manboo.

No 2 changed what was cl 11 in No 1 to cl 12 and added a new cl 11:

Reference herein to "the Mortgage" shall be read and construed as a reference to the Mortgage together with the Deed of Further Change (sic -- presumably, Charge) of even date herewith.

Nothing was "herewith", at least so far as the evidence in this application was concerned. The only evidenced instrument "of even date" was the Memorial referred to. At most this guarantee could only require the repayment of the initial advance of $930,000 and the first further loan of $150,000, a total of $1,080,000.

As No 3 was the basis of the claim to vote, and the only one to be the subject of a demand, it is the key guarantee for present purposes. It contains the same cll 11 and 12 as No 2 but identified the mortgage as one dated 5 May 1989. No mortgage or further charge of that date was placed in evidence. What is in evidence is Memorial Book 877 No 945 purporting to record details of a registered instrument dated 5 May 1989 called a Deed of Variation of Mortgage No 887 in Book 858 made on 23 September (with no year) to secure $1,080,000. The debtor therefore submitted that at best No 3 was guaranteeing a non-existent mortgage. If, contrary to that submission, it secured $1,080,000, the valuation basis for the right to vote suggested at the Part X meeting would not have provided any entitlement to vote at all. If on the other hand the subsequently realised sale price of $920,000 was the only set off, a vote based on No 3 could only have been exercised to a maximum of $160,000 instead of the $730,000 claimed at the meeting. No submission was made, perhaps because the evidence does not reveal, what the fate of the Part X deed would have been in that event.

5 The demand

Despite the applicants' submission to the contrary, the debtor's contention that a demand is a necessary pre-condition to liability may follow from the language of cl 5, and possibly from the fact that a demand was in fact served: see O'Donovan and Phillips, The Modern Contract of Guarantee (Law Book Co 1985) pp 379 ff. However, as a demand was in fact served, and is relied on by the applicants for the various purposes earlier referred to, and because its content was the basis of the claim to vote, it is not necessary to decide whether it was essential.

The demand in evidence is dated 28 May 1991. Addressed to the debtor, it states:

WHEREAS you are indebted to FARROW MORTGAGE SERVICES PTY LTD (IN LIQUIDATION) (FORMERLY COMBINED MORTGAGE SERVICES PTY LTD) of 100 Brougham St, Geelong ("the Mortgagee") on account of Manboo Pty Ltd pursuant to an Instrument of Guarantee in favour of the Mortgagee executed by you and dated the 5th day of May 1989.

The Mortgagee HEREBY DEMANDS that you forthwith pay to the Mortgagee the total sum (together with interest accrued on a daily basis) as referred to in the Schedule hereto. If payment is not made forthwith to the Mortgagee then the Mortgagee may exercise its rights pursuant to any securities which it holds.

The schedule identifies the sum said to be owing as $1,838,821.31. The demand was contained in a letter from Farrow's solicitors dated the same day, the relevant parts of which stated:

Pursuant to an Instrument of Guarantee dated the 5th day of May 1989 from you to our client, you have guaranteed the performance of Manboo Pty Ltd to our client.

For your information Manboo Pty Ltd is in default of its obligations to our client.

Accordingly, we enclose by way of service Demand.

The debtor contended that whatever the words in the demand "on account of Manboo Pty Ltd" mean, Manboo owed and could have owed nothing (except rates, etc). This is because Manboo was only liable to have the subject land sold if Janthol failed to pay "the moneys secured". There was no covenant by Manboo to pay those moneys either in the mortgage or the debenture. Thus the debtor could not owe anything. Moreover, the guarantee of 5 May 1991 did not guarantee the $1.838m claimed in the demand. Nor could the guarantee have any force unless and until, by cl 2, the obligations could not be enforced against Manboo. There is no evidence of any such unenforceability, the only evidence being default in payment by Manboo. If the debtor is correct that Manboo had no obligation to pay when Janthol defaulted, the guarantee is not activated.

In this connection, Farrow and the liquidator cited the observations of Chief Justice Mason in Sunbird Plaza Pty Ltd v Maloney (1987-88) 77 ALR 205 at 209:

There are, however, two common classes of guarantee of the payment of instalments by the principal debtor. The first is an undertaking by the guarantor that if the debtor fails to pay an instalment he will pay. This is a conditional agreement. The guarantor's obligation to pay arises on the debtor's failure to pay. The second is an undertaking by the guarantor that the debtor will carry out his contract.

Then a failure by the debtor to perform his contract puts the guarantor in breach of his.

At 219 Justice Gaudron approved the words used by Lord Reid to draw the same distinction in Lep Air Services Ltd v Rolloswin Investments Ltd (reported as Moschi v Lep Air Services Ltd) (1973) AC 331 at 344-5:

With regard to making good to the creditor payments of instalments by the principal debtor there are at least two possible forms of agreement. A person may undertake no more than if the principal debtor fails to pay an instalment he will pay it. On the other hand, the guarantor's obligations may be of a different kind. He might undertake that the principal debtor will carry out his contract. Then, if at any time and for any reason, the principal debtor acts or fails to act as required by his contract, he not only breaks his own contract but he also puts the guarantor in breach of his contract of Guarantee. Then the creditor can sue the guarantor not for the unpaid instalment, but for damages.

His contract being that the principal debtor would carry out the principal contract, the damages payable by the guarantor must then be the loss suffered by the creditor due to the principal debtor having failed to do what the guarantor undertook he would do.

I must confess to not being able to see how these observations are relevant to or contribute to the resolution of the present case. At most they throw up the fact that some guarantees will only give rise to or create contingent or unliquidated debts which could not found a right to vote at a Part X meeting of creditors.

There seems no doubt that the court has power and, subject to discretionary issues, is obliged to declare an arrangement void if a chairman makes a relevantly wrong decision: Musolino v Sidiropoulos (1991) 101 ALR 235 at 242-5; Forshaw (above). If the first respondent was wrong and the debt as claimed by Farrow was correct, the debtor conceded that the special resolution would not have been carried.

I agree with Justice Heerey in McLean that the weight of authority appears to favour the hearing rather than the meeting as the time to assess the cogency of the alleged debt said to provide or justify the right to vote. But the court must be alive to the restrictions or limitations on the obligations of chairpersons discussed in Levy and Forshaw. The law surely cannot be that this court, on an application to overturn a chairman's decision, must embark for example on what may amount to a rectification suit or an action for declaratory relief as to the parties' intentions or compact. I discussed some other rather unusual circumstances where reservations might also be appropriate Re Brewer Ex Parte Eurodollar Pty Ltd, unreported 26 August 1992.

Whichever is the correct approach, in my opinion the applicants have far from established a debt to any requisite or reasonable degree of satisfaction even now, let alone at the time of the meeting. Perhaps some of the instruments in this matter can be rectified. It may be that the Manboo mortgage can be construed, in full fledged litigation on the matter, to impose on Manboo an obligation to pay any indebtedness of Janthol to Farrow. For myself, at least for the purposes of this type of litigation, I have difficulty seeing it. If there was any debt at all, it is at least arguably open, even now, that the debt was little if any greater than the amount realised on the sale of the Manboo property. It is certainly not clear to me what Farrow's debt is, or that there is one.

Moreover, the guarantee of 5 May 1989, on which the demand was issued and the claim made for voting rights at the Part X meeting, seems to me, as it presumably seemed to the first respondent as chairman of the meeting, to be quite unproductive of sufficient clarity to have permitted then, and to permit now, voting rights on its account. Quite apart from the possibility that Manboo may have no liability to Farrow for any indebtedness of Janthol, and assuming there was something in that connection to guarantee, it seems to me not to be a guarantee of any such liability. There was no mortgage evidenced which that guarantee was said to secure. Certainly the guarantee could not be quantified, now or at the meeting, at anything like the amount for which Farrow claimed to vote. It could not be actioned unless and until the debt was shown to be unenforceable against Manboo. At the earliest, that could not have been until there was evidence of unsuccessful efforts to recover moneys under the debenture charges over the property and assets of Janthol and Manboo. There was no such evidence.

For its part the demand depended on liability under a guarantee which was premised not on the Manboo or any other mortgage, but on a deed of variation of the mortgage. If at all, this would only have given rise to a maximum liability of $250,000 plus interest, against which had to be set off the payments made on the Janthol loan account and the proceeds of the sale of the Manboo property. It was not possible to attribute the loan payments to anything identifiable; and the proceeds of sale exceeded the maximum amount thereby guaranteed.

In order to grant the application under subs (2) of s 222, the court must find, in accordance with subs (1), that:

(a) the application is brought by a creditor
(b) there is a doubt
(c) on a specific ground
(d) as to whether the deed was entered into in accordance with the Act or
(e) as to whether the deed complies with the Act's requirements.

I am not satisfied that Farrow is a creditor. Nor do I entertain either of the relevant doubts. The application under this subsection therefore fails.

To terminate a deed of arrangement under subs (1) and (2) of s 236, the court must be satisfied that:

(a) the application is brought by a creditor
(b) the debtor has failed to carry out or comply with the deed
(c) the deed cannot be proceeded with without injustice or undue delay
(e) termination is in the interests of creditors.

Because of the inadequacy of the evidence to establish that the debtor was indebted to Farrow, this application must also fail. But Farrow's argument was that a good "other reason" for termination existed because it was a creditor with an ascertained debt which was wrongly excluded from voting. It did not argue that the debtor's failure to pay all the instalments due under the deed was enough to order termination. This approach is interesting in the light of the debtor's argument that if all his other arguments failed, the discretions provided for in ss 222(2) and 236(1) should be exercised to deny Farrow the relief sought. The suggested grounds were the delay between the special resolution and the issue of the application, the reasonableness of the arrangement proposed, and Farrow's own conduct in supplying inadequate information and support documentation to the first respondent as chairman of the meeting.

In the light of my other conclusions, it is unnecessary to rule finally on the discretionary issues raised by the application. However, I should have thought it unlikely that where a debtor has substantially failed to comply with the arrangement, a wrongly excluded creditor would be denied relief because of a year's delay in taking action and a failure to particularise the debt. There is no evidence in this case as to the reasonableness of the arrangement contained in the deed except that the creditors voted for it. Hence if this matter fell for determination on discretionary grounds, my inclination would have been to grant rather than refuse the relief sought.

I can detect no error on the part of the first respondent as chairman of the Part X meeting in declining the applicants the right to vote. The application will be dismissed with costs.

Order

The court orders:

1. Application dismissed.
2. Applicants to pay respondents' costs.

Note: Settlement and entry of orders are dealt with in accordance with O 36 of the Federal Court Rules.

Counsel for the applicants: *Mr D H Denton*

Solicitors for the applicants: *Molomby and Molomby*

Solicitors for the respondents: *Mr G T Bigmore of J M Smith and Emmerton*