SUPREME COURT OF QUEENSLAND

CITATION:	*Surfers Paradise Investments Pty Ltd (In Liq) v Davoren Nominees Pty Ltd* [2003] QSC 025
PARTIES:	**SURFERS PARADISE INVESTMENTS PTY LTD (IN LIQUIDATION)** (applicant) and **DAVOREN NOMINEES PTY LTD (ACN 010 940 128)** (respondent)
FILE NO/S:	S156/03
DIVISION:	Trial Division
PROCEEDING:	Application
ORIGINATING COURT:	Supreme Court at Brisbane
DELIVERED ON:	18 February 2003
DELIVERED AT:	Brisbane
HEARING DATE:	16 January 2003
JUDGE:	Mackenzie J
ORDER:	**1. Upon the respondent by its counsel undertaking to forthwith pay to the liquidator of the applicant the sum of $53,992.50 together with interest thereon at the rate of 8% from 14 February 2002 to the date of payment, it is declared that in the events that have occurred the respondent did not surrender registered mortgage No 703385419 over lot 4 on registered plan 213382, County of Ward, Parish of Barron, as security for any principal or interest outstanding pursuant to the said mortgage;** **2. That subject to the same undertaking the respondent is entitled to the net proceeds of sale of the real property referred to in paragraph 1 together with accretions thereto, if any.** **3. No order as to costs.**
CATCHWORDS:	BANKRUPTCY – ADMINISTRATION OF PROPERTY – PROOF OF DEBTS – PROOFS BY AND AGAINST PARTICULAR PERSONS – SECURED CREDITORS – GENERALLY – where the applicant gave a mortgage over land as security for the advance of a loan – where the applicant company entered liquidation – where the respondent exercised its power of sale under the mortgage

and entered into contracts for sale of the above lots – where the respondent submitted formal proof of debt – where the liquidator paid the respondent a dividend based on that proof of debt – where the applicant claims the proceeds of sale of one Lot – whether the applicant elected to surrender the mortgage over that lot in accordance with s 554 Corporations Law – whether the respondent demonstrated an intention to surrender the security

Corporations Act 2001 (Cth), s554E

Kelso v McCulloch (unreported, SCNSW, Equity Division, J 3832 of 1994, Young J, 24 October 1994), applied
Moor v Anglo-Italian Bank (1879) 10 Ch D 681, applied
Re: Douglas Homes Qld Pty Ltd (in liq) [1980] Qd R 528, applied
Seventeenth Canute Pty Ltd v Bradley Air-Conditioning Pty Ltd (in liq) (1987) 1 Qd R 111, applied

COUNSEL: J.B. Sweeney for the applicant
P.E. Hack SC for the respondent

SOLICITORS: MacGillivrays for the applicant
Davoren Associates for the respondent

[2] **MACKENZIE J:** This is an application for declarations that the respondent has surrendered a registered mortgage over certain lands, which it is convenient to describe as Lots 4, 5 and 6 as security for principal and interest outstanding pursuant to the mortgage and that, as against the respondent, the applicant is entitled to the net proceeds of the sale of Lot 4. The respondent is a mortgage lending company associated with Davoren Associates, Solicitors, on the Gold Coast. The liquidator of the applicant claims that the surrender occurred by reason of the circumstances which are summarised in the following paragraphs.

[3] The applicant gave a mortgage over three contiguous lots, 4, 5 and 6 on registered plan 213382, on the 9 June 1999 as security for an advance of $1.8M. On 25 February 2000, Mr Starkey was appointed administrator of the applicant, and on 5 May 2000, its liquidator. In the meantime, on 10 March 2000, a notice of exercise of power of sale was served on Mr Starkey, who had the properties valued. On a forced sale basis the properties were valued at $900,000 to $1M.

[4] On 19 June 2001 the respondent contracted to sell Lots 5 and 6 for $1.3M. The contract settled on 12 September 2001. On 13 September 2001 Mr Picken, a solicitor employed by Davoren Associates, sent a notice of completion of sale referring to the property sold as Lots 5 and 6, but describing them as the "whole" of the property subject to the mortgage. This error occurred, according to him, because he used a precedent which related to the sale of the whole of the mortgaged property and failed to amend it to suit the circumstances of the case.

[5] With respect to Lot 4, a conditional contract was entered into for its sale on 12 December 2001, but it was terminated on 21 December 2001 during due diligence. Negotiations to sell it continued and another contract was entered into in respect of it on 12 February 2002. It settled on 29 November 2002 for a net amount of just over $900,000. The claim in the application relates to the proceeds of the sale of Lot 4.

[6] The events upon which the claim that the applicant is entitled to these monies begin with Mr Starkey requiring all creditors to submit formal proofs of debt. On 9 August 2001, Mr Davoren, a solicitor, but in his capacity as director of the respondent, executed the appropriate form for that purpose stating that the applicant was indebted to the respondent in a specified sum (of about $2.2M) being principal and interest outstanding pursuant to a registered mortgage. At the time that was mathematically accurate since the contract relating to lots 5 and 6 had not yet been completed. As previously explained this was followed on 13 September 2001 by a notice of completion of sale referring to Lots 5 and 6 as the whole of the property subject to the mortgage. On 18 September 2001 Mr Starkey requested that he be provided with details of the debt following the sale of the property. On 24 September 2001 he received a letter prepared by Mr Coman in which the current debt was stated to be a specific sum (a little more than $1.1M) after taking into account the proceeds of the sale of Lots 5 and 6. No estimate of the value of the security remaining was made.

[7] On 11 February 2002 Mr Starkey paid a dividend of about $54,000, based on the proof of debt. The accompanying statutory notice explained that the interim dividend was 4.9¢ in the dollar on the approximately $1.1M debt as admitted to rank for dividend. It also stated that the cheque should be banked promptly because payment would be stopped after eight weeks. Mr Coman, a partner in Davoren Associates and also a director of the respondent, deposed that he had caused the interim dividend cheque to be banked promptly in compliance with the direction in the Declaration of Interim Dividend. The approximately $54,000 was credited against the account owing by the applicant. He said that when he caused the interim dividend cheque to be banked he did so without understanding or considering the possibility that the respondent may have been taken to have surrendered its security.

[8] The issue of the surrender of the mortgage did not emerge, it appears, until an unsecured creditor raised concerns with Mr Starkey about the sale of Lots 4, 5 and 6. In consequence of that, Mr Starkey wrote on 13 November 2002 to Davoren Associates asking whether they had been sold and whether there were any surplus funds available after discharging the mortgage to the respondent. By a letter of 14 November 2002, he was advised that the properties had been sold and that there was no surplus. This exchange had occurred about two weeks before the sale of Lot 4 was settled.

[9] On 20 November 2002 Mr Starkey requested a full account in respect of the sale of the properties. On 22 November 2002 he received documents, including the contract relating to Lot 4. The same day he discussed the transaction with Mr Picken. On 25 November 2002 he received a draft statement showing the balance of the debt due to the respondent was about $390,000. This represented a sum

arrived at by deducting the sale proceeds and the dividend paid by the liquidator from the principal and interest remaining unpaid following the sale of Lots 5 and 6.

[10] On 26 November 2002 Mr Starkey arranged for a caveat to be lodged in respect of Lot 4. He subsequently offered to release the caveat to allow the contract to settle on 29 November 2002 if the proceeds were paid into his solicitor's trust account and he was satisfied that the sale was at market value. The valuer's report he obtained satisfied him of the latter and it was agreed, with regard to the former, that the proceeds would be paid into the trust account. The caveat was withdrawn and the sale proceeded to completion.

[11] The evidence discloses a chain of events leading to the liquidator's application which went wrong at almost every opportunity. The fact there was divided responsibility for the particular transactions renders the possibility that there was organisational ataxia rather than a co-ordinated strategy to have the best of all possible worlds a more realistic possibility than it may otherwise have been. It may be observed that the proposition that none of the solicitors who were involved in individual transactions adverted to the possible consequences of what was done by them is not particularly attractive. However, explanations to that effect were advanced in their affidavits without the requirement that the deponent's evidence be tested. The criticism was limited to submissions made as to perceived differences between some of the expressions in the affidavits. In the circumstances I am not prepared to reject the explanations given.

[12] Section 554E of the *Corporations Act* 2001 (Cth) provides as follows:

> "(1) In the winding up of an insolvent company, a secured creditor is not entitled to prove the whole or a part of the secured debt otherwise than in accordance with this section and with any other provisions of this Act or the regulations that are applicable to proving the debt.
>
> (2) The creditor's proof of debt must be in writing.
>
> (3) If the creditor surrenders the security to the liquidator for the for the benefit of creditors generally, the creditor may prove for the whole of the amount of the secured debt.
>
> (4) If the creditor realises the security, the creditor may prove for any balance due after deducting the net amount realised, unless the liquidator is not satisfied that the realisation has been effected in good faith and in a proper manner.
>
> (5) If the creditor has not realised or surrendered the security, the creditor may:
>
> (a) estimate its value; and
> (b) prove for the balance due after deducting the value so estimated.

> (6) If subsection (5) applies, the proof of debt must include particulars of the security and the creditor's estimate of its value."

[13] The principle inherent in s 554E is of long standing. An early, but no means the earliest, discussion of it may be found in *Moor v Anglo-Italian Bank* (1879) 10 Ch D 681 ("*Moor")* where Jessel MR said the following at 689-690:

> "In bankruptcy, if a secured creditor wants to prove, he must do one of three things: he may give up his security altogether and prove for the full amount, or he may get his security valued and prove for the difference, or he may sell and realise his security and then prove for the difference. If, without doing either of the latter two things, he proves for the full amount, as he cannot prove for the full amount and receive a dividend except on the theory of giving up the security, he shews by that an intention to give up his security; and, if he so proves and receives a dividend or votes, he shews pretty conclusively that he has finally elected to give up his security and take his dividend; in other words, having two funds to resort to, the bankrupt's general estate, so as to get a dividend on the whole amount of his debt, or his security, he elects to take the bankrupt's general estate and in that way gives up his security. It is not forfeiture, it is election; but, the petitioning creditor gets nothing unless he proves. There is no obligation on the petitioning creditor to prove; he may make the man a bankrupt, and then he may be satisfied as far as he is concerned, and leave other creditors to prove; he does not elect simply by making a man a bankrupt."

[14] As is said in that passage the decision that a secured creditor has surrendered his security involves a finding that the debtor has elected to give up the security. Objective evidence that the creditor has sought to avail himself of rights and remedies available to unsecured creditors is evidence tending to suggest an intention to give up the security and prove as an unsecured creditor. However, that inference may be displaced by other evidence.

[15] Two examples where the secured creditor succeeded in resisting the notion that the security has been surrendered are *Re: Douglas Homes Qld Pty Ltd (in liq)* [1980] Qd R 528 ("*Douglas Homes*") and *Kelso v McCulloch* (unreported, SCNSW Equity Division, J 3832 of 1994, Young J, 24 October 1994) ("*Kelso*"). In *Douglas Homes* after referring to *Moor*, D M Campbell J said at 530 that while the proof of debt was evidence of an election to surrender the security, it was not conclusive evidence. The facts were that contemporaneously with giving proof of debt to the liquidator (which did not include an assessment of the value of the security), the secured creditor notified that it had gone into possession of the mortgaged property and was exercising its power to sell it. Upon a claim being made by the liquidator that the security had been surrendered, he was immediately met with a denial and an assertion that the intent was to deal with the property as mortgagee in possession on default.

[16] In *Kelso,* Young J referred to *Douglas Homes* in advancing the proposition that an election to surrender a security is not to be imputed to a creditor unless conduct shows that he has unequivocally elected. In *Seventeenth Canute Pty Ltd v Bradley Air-Conditioning Pty Ltd* (in liq) [1986] 1 Qd R 111 ("*Seventeenth Canute*") the essential facts were that a company in liquidation owed the respondent monies in respect of which the respondent had claimed a sub-contractor's charge. The company in liquidation entered into a scheme of arrangement which by its terms, excluded sub contractors. There was evidence that the respondent did not expect to receive anything from the sub contractor's charge and asserted in its proof of debt under the scheme of arrangement that it had received no satisfaction or security for the debt. Notwithstanding that pessimistic view of the worth of the charge, the respondent received payment under it and also a dividend as unsecured creditor. It was held that, on the facts, the proof of debt constituted notice to the scheme trustees that the creditor had elected to be treated as an unsecured creditor and not a sub contractor.

[17] In the course of discussion of authority, including *Moor*, reference was made without disapproval to *Douglas Homes*. It was treated as an example of a case where inconsistent contemporary conduct led to the conclusion that the omission to value the security as inadvertent. (That concept relates to what is now s 554G of the *Corporations Law*: if the estimate of the value of the security is made in good faith on a mistaken basis, or the value of the security has changed since the estimate was made the liquidator or the court may permit the creditor to amend the proof of debt on such terms as it thinks just and equitable). The preliminary question is whether the inference should be drawn from the facts that the security has been surrendered.

[18] In *Seventeenth Canute*, by contrast with *Douglas Homes* and *Kelso*, the unchallenged evidence was held to clearly establish that the proof of debt in the form in which it was submitted was a carefully considered act on the part of the respondent. *Seventeenth Canute* is not inconsistent with the notion that the question of surrender is ultimately a factual one. Even though facts may objectively point to the conclusion that the security has been surrendered, subjective factors of sufficient weight may displace that inference.

[19] The respondent's situation is not as compelling as those of the security holders in *Douglas Homes* or *Kelso*, but the question remains whether the applicant has established that there was an election to surrender the security. There is evidence that at all times the respondent was pursuing sale of the mortgaged properties. The efforts were continuing at the time when the proof of debt was lodged. On the evidence as it stands I am not satisfied that there was at any time an intention to surrender the security to the liquidator.

[20] It is accepted that the respondent cannot retain the amount of the dividend paid to it. It has undertaken through its counsel to return that sum with interest. The declaration that it has not surrendered the security would be subject to that undertaking. As regards costs, I am satisfied that although the liquidator has been unsuccessful, in all the circumstances it would have been imprudent for him not to bring the present action, which is the sole consequence of the conduct of the

directors and of solicitors for the respondent. In the circumstances I propose to make no order as to costs.

[21] The orders are the following:

1. Upon the respondent by its counsel undertaking to forthwith pay to the liquidator of the applicant the sum of $53,992.50 together with interest thereon at the rate of 8% from 14 February 2002 to the date of payment, it is declared that in the events that have occurred the respondent did not surrender registered mortgage No 703385419 over lot 4 on registered plan 213382, County of Ward, Parish of Barron, as security for any principal or interest outstanding pursuant to the said mortgage;
2. That subject to the same undertaking the respondent is entitled to the net proceeds of sale of the real property referred to in paragraph 1 together with accretions thereto, if any.
3. No order as to costs.