

SUPREME COURT OF QUEENSLAND

CITATION: *Combis & Ors v The Trust Company Ltd* [2011] QSC 388

PARTIES: **NICK COMBIS AND PETER GEORGE BIAZOS**
(first plaintiffs)
and
NOLIMIT 16 PTY LTD (RECEIVERS AND MANAGERS APPOINTED) (IN LIQUIDATION) (ACN 115 856 203)
(second plaintiff)
v
THE TRUST COMPANY LIMITED (ACN 004 027 749)
(defendant)

FILE NO: 10350 of 2010

DIVISION: Trial Division

PROCEEDING: Trial of separate issue

ORIGINATING COURT: Supreme Court at Brisbane

DELIVERED ON: 16 December 2011

DELIVERED AT: Brisbane

HEARING DATE: 24 November 2011

JUDGE: Applegarth J

ORDER: **Separate question answered: “As at 5 July 2011 the defendant’s security had already been discharged and accordingly regulation 5.6.24(3) of the *Corporations Regulations 2001* (Cth) did not apply in the circumstances pleaded in paragraphs 33-37 of the Second Further Amended Answer filed 9 September 2011”.**

CATCHWORDS: MORTGAGES – ESTATE, RIGHTS AND LIABILITIES OF MORTGAGOR AND MORTGAGEE – DISCHARGE OR RECONVEYANCE – GENERALLY – where defendant held second-ranking mortgage over property owned by second plaintiff company – where first mortgagee appointed receivers and managers to the property – where receivers proposed to sell the property – where defendant agreed to discharge its mortgage in order to allow clear title to pass to buyer of the property – where the discharge was conditional upon an undertaking by the receivers that the surplus proceeds of sale would be held in a trust account pending the determination of priorities between the first mortgagee and the defendant – where liquidators of the company subsequently claimed that the second mortgage was a voidable transaction and dispute arose as to entitlement to

surplus proceeds of sale – where liquidators called a meeting of creditors and the defendant exercised voting rights in respect of the whole debt claimed – where liquidators claimed that the defendant thereby surrendered its security by virtue of reg 5.6.24(3) of the *Corporations Regulations 2001* (Cth) – whether second mortgagee held a “security” capable of being surrendered at the creditors’ meeting – whether second mortgagee discharged its security or whether the mortgage created a security over surplus proceeds of sale – whether surplus proceeds of sale held on trust pending resolution of proceedings

Corporations Regulations 2001 (Cth), reg 5.6.24

Aircon Heating and Airconditioning Pty Ltd (in liq) v Crane Distribution Ltd [2006] VSC 76 cited

AVCO Financial Services Ltd v Commonwealth Bank of Australia (1989) 17 NSWLR 679 cited

Bofinger v Kingsway Group Ltd (2009) 239 CLR 269; [2009] HCA 44 cited

Charles v Jones (1887) 35 Ch D 544 cited

Re Kimberley NZI Finance Ltd v AR Barr Investments Pty Ltd [1990] FCA 54 cited

La Trobe Capital & Mortgage Corporation Ltd (No 2) [2009] NSWSC 1372 cited

Lloyds Bank NZA Ltd v National Safety Council of Australia Victorian Division (in liq) (1993) 2 VR 506 cited

Re Miles; Ex parte National Australia Bank Ltd (1988) 20 FCR 194; [1988] FCA 409 cited

Re Murrell; Ex parte Official Trustee in Bankruptcy (1984) 57 ALR 85; [1984] FCA 314 cited

Residential Housing Corporation v Esber [2011] NSWCA 25 cited

Re S & D International Pty Ltd (in liq) [2009] VSC 225 cited
St George Bank Ltd v Perpetual Nominees Ltd [2011] 1 Qd R 389; [2010] QSC 57 cited

COUNSEL: D G Clothier for the plaintiffs
D A Kelly SC for the defendant

SOLICITORS: Tucker & Cowen for the plaintiffs
Allens Arthur Robinson for the defendant

- [1] The defendant (“Trust Company”) held a second-ranking mortgage over real property owned by the second plaintiff (“NL16”). The first-ranking mortgagee was the Bank of Western Australia Limited (“BankWest”). BankWest appointed receivers and managers to NL16. The receivers and managers proposed to sell the real property, and an issue arose between BankWest and Trust Company as to their respective entitlements to the surplus proceeds of sale. This issue was whether BankWest was entitled to be paid in priority to Trust Company from the surplus proceeds of sale (after payment of NL16’s direct facilities with BankWest and

costs) amounts that were payable to BankWest on account of guarantee obligations that NL16 had assumed in respect of related companies.

- [2] The receivers and managers wished to pass clear title to the buyer of the property. To facilitate settlement of the contract, Trust Company was prepared to provide a discharge of its mortgage on the basis that any surplus was held “on trust pending verification of priority claims.” Its requirements in that regard were documented in an undertaking dated 23 June 2010 (“the Undertaking”).
- [3] Trust Company executed and provided a Discharge also dated 23 June 2010 releasing the mortgage over the property (“the Discharge”). The contract of sale settled, and the surplus proceeds were held in accordance with the Undertaking.
- [4] On 24 September 2010 the liquidators of NL16, along with NL16 itself, commenced these proceedings claiming an entitlement to the surplus. These claims were made on the grounds that Trust Company’s guarantee and mortgage were voidable transactions under the provisions of the *Corporations Act 2001* (Cth), or that they were liable to be set aside on the alternative ground that they were entered into in consequence of Trust Company’s knowing participation in breaches of duty by NL16’s director. The essential bases of these claims are allegations that Trust Company’s guarantee and mortgage were obtained as a means of obtaining further security for a defaulting loan in favour of another company in the No Limit Group (“NL7”), were entered into at a time when both NL7 and NL16 were insolvent, and that the mortgage and guarantee have produced no benefit to NL16, were unlikely to do so and constituted a significant detriment to NL16.
- [5] After negotiations, Trust Company, BankWest, the receivers and managers of NL16, the liquidators of NL16 and other parties entered into a deed dated 7 December 2010 (“the Deed”) in relation to the surplus. In short, the Deed provided for the receivers to pay BankWest its debt from the surplus that the receivers held after selling the property, and for the receivers to retain a contingency sum from the surplus. The remaining funds were then to be paid into Trust Company’s solicitor’s trust account and invested. In accordance with cl 2 of the Deed, Trust Company caused its solicitors to deliver an executed undertaking in an agreed form. That undertaking requires the firm to hold a sum described as “the Net Amount” in its trust account “to the account of or in the name of” Trust Company and not to disburse it except pursuant to the written agreement and direction of Trust Company and the liquidators of NL16 or pursuant to an order of a court.
- [6] The liquidators called a meeting of creditors of NL16 for 5 July 2011. Trust Company, through its solicitors, attended and voted at the meeting. It exercised its voting rights in respect of the whole of the amount claimed in a proof of debt submitted by it. In subsequent correspondence the liquidators’ solicitors suggested that the consequence of Trust Company exercising its voting rights in respect of the whole of the debt owed to it was that it is taken to have surrendered its security by operation of Regulation 5.6.24(3) of the *Corporations Regulations 2001* (Cth). That provision states:

“If a secured creditor votes in respect of his or her whole debt or claim, the creditor must be **taken to have surrendered** his or her **security** unless the Court on application is satisfied that the omission to value the security has arisen from inadvertence.” (emphasis added)

Trust Company denied that this regulation applied on the ground that its mortgage had been discharged when the Discharge was provided to the receivers and managers and the Undertaking had been given. It made an alternative, but as yet unparticularised claim that the omission to value the security had arisen from inadvertence.

- [7] The parties agreed that the question of whether Regulation 5.6.24(3) has been engaged as a result of the meeting on 5 July 2011 was a question that could and should be decided as a preliminary question on the basis of facts that are not in dispute. The secondary issue of inadvertence is not the subject of the preliminary question. On 13 October 2011 the parties consented to an order pursuant to r 483(1) of the *Uniform Civil Procedure Rules* 1999 (Qld) that the allegations contained in specified paragraphs of the pleadings that give rise to the issue of whether Regulation 5.6.24(3) has been invoked should be determined separately and in advance of other allegations in the proceeding. The application was heard by me in the Applications List on 24 November 2011.

The issue

- [8] The essential issue is whether as at 5 July 2011 Trust Company had a “security” that was capable of being surrendered.
- [9] The plaintiffs contend that the mortgage was surrendered by operation of Regulation 5.6.24(3). Trust Company contends that its mortgage had been earlier discharged, and that the money paid into the trust account in accordance with the Deed was not property that was subject to the mortgage or any other form of security that was capable of being surrendered. It submits that it was because its mortgage was to be discharged that it sought and obtained the Undertaking dated 23 June 2010 with respect to the proceeds of sale, and that its interest in the surplus funds held in the trust account cannot be described as a “security”.
- [10] The plaintiffs argue that the Undertaking and the subsequent Deed simply established processes to preserve the proceeds of sale pending resolution of entitlements to those proceeds, and that the Discharge released the mortgage over the real property but did not release Trust Company’s security over the proceeds.

Background facts

- [11] The facts are not in dispute. NL16 was one of a number of companies in the No Limit Group. It owned a property located in Victoria named Sydenham Village.
- [12] On 14 May 2009, NL16 (and other related companies) executed a guarantee and indemnity in favour of Trust Company in respect of the indebtedness to Trust Company of another related company, Nolimit 7 Pty Ltd (NL7). NL16 agreed to pay to Trust Company “on demand” all amounts which NL7 was required to pay under or in respect of NL7’s facility agreement. Under the terms of the guarantee, moneys were not taken to have been received by Trust Company unless actually received and retained by it without there being any outstanding arguable claims in relation to them.
- [13] As security for its obligations under the guarantee, NL16 provided Trust Company with a mortgage over Sydenham Village. The mortgage bears the date 29 January 2010, although Trust Company alleges that it was in fact executed at the

time of the guarantee. Nothing turns on that for present purposes. Trust Company's mortgage over Sydenham Village was registered on 1 February 2010. It was ranked behind a mortgage in favour of BankWest.

- [14] Trust Company's mortgage included the following terms:
- (a) It was over Sydenham Village as well as any proceeds of sale of Sydenham Village;
 - (b) NL16 was obliged to pay the secured money in full, not to make a set-off, counterclaim or deduction, and not to attach any condition to the payment except as required or permitted by legislation; and
 - (c) Trust Company was not obliged to discharge the mortgage unless requested to do so in writing and only if the secured money had been paid in full and all obligations under the mortgage and any other security had been performed.
- [15] BankWest appointed receivers and managers to NL16 on 1 March 2010. Liquidators were appointed on 23 April 2010.
- [16] The receivers caused a contract of sale of Sydenham Village (dated 11 June 2010) to be entered into. A dispute then arose as to the entitlement to surplus proceeds of sale after the payment of NL16's direct facilities with BankWest and costs. BankWest suggested that the surplus might be payable to it on account of guarantee obligations NL16 had assumed in respect of related companies.

The Discharge and the Undertaking

- [17] In order to pass clear title to the buyer of the property, the seller had to obtain discharges of the mortgages over it. In the case of the Trust Company's mortgage, negotiations occurred in late June 2010 between representatives of the receivers and representatives of Trust Company. Trust Company indicated that it was agreeable to the receivers' request to provide a partial release of a charge over the company and a discharge of its mortgage over the property "on the basis that any surplus is held on trust pending verification of priority claims." It was necessary for an Undertaking to be prepared for Trust Company's review and approval. Trust Company was under no obligation to provide a discharge of its mortgage over the property because the secured money had not been paid in full. Instead, it agreed to provide the requested Discharge on the basis that it would be provided with the Undertaking that it required in relation to the surplus proceeds of sale.
- [18] The Undertaking was dated 23 June 2010 and:
- (a) recorded the existence of the Trust Company's mortgage and the fact that Trust Company wished to consider whether BankWest's securities secured any other indebtedness of NL16 to BankWest in priority to Trust Company's mortgage;
 - (b) recorded that in consideration of the receivers giving the Undertaking, Trust Company would give to the receivers a discharge of Trust Company's mortgage to enable NL16 to complete the contract by 25 June 2010; and

- (c) provided that after payment of NL16's direct facilities with BankWest and costs, the balance proceeds were to be deposited into the trust account of the receivers' solicitors (Freehills) and were not to be released without the written consent of BankWest and Trust Company or an order of a Court.

[19] Clause 3 of the Undertaking stated:

“The Receivers undertake to Trust Company that they will only authorise or make payments from the purchase price payable by the Purchaser to the Vendor under the Contract for the following purposes:

- (a) without limiting paragraph (c) below, to pay the Vendor's and the Receivers' costs and expenses incurred in respect of the sale of the Land;
- (b) to pay all principal, interest, costs and charges owing by [NL16] to Bankwest in respect of the Nolimit 16 Facilities;
- (c) to pay the Receivers' remuneration, and all liabilities, costs and expenses incurred or to be incurred by the Receivers in their capacity as receivers and managers of the property, rights and undertaking of [NL16];
- (d) to deposit the funds into an interest bearing account established by the Receivers pending the making of the payments contemplated by paragraphs (a) to (c) above;
- (e) to pay to Freehills any funds held by the Receivers after making the payments contemplated by paragraphs (a) to (c) above to be held in their trust account and not to be released without the written consent of BankWest and Trust company, or by order of a Court of competent jurisdiction[;]
- (f) to make any other payments authorised in writing by BankWest and Trust Company, or by order of a Court of competent jurisdiction.”

[20] The Discharge that was provided in exchange for the Undertaking stated that the “mortgagee or annuitant discharges the land described from the moneys or annuity secured by the mortgage or charge specified” and referred to Trust Company's registered mortgage. The Discharge was registered on 2 July 2010. As a result, the property was released from Trust Company's mortgage. The release of the property occurred by virtue of the wording of the Discharge and also by operation of s 84 of the *Transfer of Land Act 1958* (Vic) upon the recording of it in the Register. Section 84(1) relevantly provides:

“Upon submission of an instrument in an appropriate approved form signed by the mortgagee or annuitant discharging the land or part thereof from the whole or part of the moneys or annuity secured the Registrar shall make a recording to that effect in any relevant part of the Register, and thereupon the land or the portion of land described

in the instrument shall cease to be subject to or liable for such moneys or annuity or for such part thereof.”

- [21] Of the surplus funds received by the Receivers, in mid-August 2010 it was agreed that \$1,663,416.20 would be disbursed to the Trust Company with the balance held pursuant to the Undertaking.

The Deed

- [22] On 27 August 2010 the liquidators appointed to NL16 challenged the validity of the NL16 mortgage. The receivers declined to disburse the funds as agreed pending resolution of the question whether the surplus funds should be distributed to Trust Company or NL16 (in effect to the liquidators). An agreement was reached between the receivers, Trust Company, BankWest, NL16, Nolimit 10 Pty Ltd (In Liquidation) (“NL10”) and the first plaintiffs (in their capacity as liquidators of NL16 and NL10). That agreement dealt with the preservation of the surplus proceeds of sale pending the outcome of these proceedings. This agreement was given effect by the Deed, dated 7 December 2010.

- [23] Relevantly, the Deed recited that:

- (a) The receivers sold Sydenham Village and held the surplus.
- (b) BankWest wished to be paid its debt from the surplus.
- (c) The receivers wished to retain a contingency sum from the surplus.
- (d) Trust Company said that, pursuant to its guarantee and mortgage, it is entitled to the net amount, being the surplus less BankWest’s debt and the contingency sum.
- (e) The liquidators and NL16 had commenced proceedings against Trust Company seeking, amongst other things, orders declaring the guarantee and Trust Company’s mortgage void.
- (f) Trust Company denied the allegations made in the proceedings and had filed its counterclaim.
- (g) Pending a determination or agreement as to the respective entitlements of the parties to the BankWest mortgage of the proceedings, the parties wished to preserve the surplus less BankWest’s debt and the contingency sum (“the Net Amount”).

- [24] The Deed included the following definitions in cl 1.1:

“**Contingency Sum** means the sum of \$45,000 to be held by the Receivers as a contingency against future costs and expenses incurred in the course of the receiverships of NL16 and NL10 or any remuneration payable to the Receivers for work done in the course of those receiverships.

...

Debt means all amounts due and owing by NL16 (whether as borrower or guarantor) to BankWest, which as at 7 December 2010 is \$624,047.64.

...

Net Amount means the sum of \$2,146,639.89, being the Surplus minus the Debt and minus the Contingency Sum.

...

Securities means [the NL16 Guarantee and the NL16 Mortgage].

Surplus means the moneys held by the Receivers following the sale of Sydenham Village, which as at 7 December 2010 is \$2,815,687.53.

...

Undertaking means the undertaking of Allens Arthur Robinson set in the Schedule.”

[25] The Schedule relevantly provided as follows:

“Allens Arthur Robinson hereby undertakes that upon receipt of the Net Amount, Allens Arthur Robinson shall:

1. hold the Net Amount in the Allens Arthur Robinson Trust Account to the account of or in the name of [Trust Company];
2. not disburse the Net Amount from the Allens Arthur Robinson Trust Account except:
 - (a) pursuant to written agreement and direction of [Trust Company] and the NL16 Liquidators...; or
 - (b) pursuant to an order of a Court of competent jurisdiction;
3. when, pursuant to the *Legal Profession Act 2007* (Qld), Allens Arthur Robinson is obliged to provide information to [Trust Company] in respect of the holding of the Net Amount, Allens Arthur Robinson shall, upon request, provide a copy of that information to the solicitors for the NL16 Liquidators and will furnish a trust account statement with respect to the holding of the Net Amount to the solicitors for the NL16 Liquidators upon a reasonable request being made.”

[26] Clause 2.2 of the Deed provided that:

- “(a) The Receivers shall pay the Debt to BankWest on 7 December 2010.
- (b) The Receivers shall retain the Contingency Sum to be applied in accordance with this Deed.

- (c) Immediately upon being provided with an original signed Undertaking and notice from the Liquidators that the condition in clause 2.1(b) has been satisfied (which the Liquidators shall immediately give upon the condition being satisfied), the Receivers shall pay the Net Amount to the Allens Arthur Robinson Trust Account.
- (d) If the Receivers do not incur further costs or expenses or are not entitled to further remuneration (in respect of which the Contingency Sum is being retained), the Receivers shall pay the Contingency Sum (or the balance of it) as agreed in writing between the NL16 Liquidators and [Trust Company].
- (e) If the Receivers do incur further costs or expenses or are entitled to further remuneration (in respect of which the Contingency Sum is being retained), the Receivers may pay their remuneration and those costs and expenses from the Contingency Sum.”

[27] Clause 2.4 of the Deed contained certain acknowledgments:

“(a) [Trust Company], NL10, NL16 and the Liquidators acknowledge and agree (and to the extent necessary irrevocably direct) that the Net Amount (and any accretions to it) shall:

- (i) be held in the Allens Arthur Robinson Trust Account to the account of or in the name of [Trust Company];
- (ii) not be disbursed from the Allens Arthur Robinson Trust Account or otherwise dealt with except:
 - (A) pursuant to written agreement and direction of [Trust Company] and the NL16 Liquidators; or
 - (B) pursuant to an order of a Court of competent jurisdiction.

(b) [Trust Company], NL10, NL16 and the Liquidators acknowledge and agree that:

- (i) the distribution of the Surplus and the holding of the Net Amount as set out in clauses 2.2 and 2.4;...

is:

- (A) without admission as to or of the Claims made in the Proceeding and the Counterclaim; and
- (B) without prejudice to the Rights (if any) of [Trust Company], NL10, NL16 and the Liquidators in respect of the Net Amount...”

[28] The performance of the Deed was conditional upon Trust Company causing its solicitors, Allens Arthur Robinson (AAR), to deliver to the liquidators (or their solicitors) an executed undertaking in the form annexed to the deed: cl 2.1(b). That

condition was fulfilled. As indicated above, the undertaking requires that AAR hold the Net Amount in its trust account “to the account of or in the name of” Trust Company and that AAR not disburse it except pursuant to the written agreement and direction of Trust Company and the liquidators or pursuant to an order of a Court. AAR must also provide certain information in respect of the net amount to the liquidators or their solicitors when called upon to do so.

- [29] The Net Amount (as defined in the Deed) was paid to the AAR Trust Account on or about 7 December 2010. This sum of \$2,146,639.89 has since been invested with the authority of all relevant parties. The Deed also provided for the receivers to pay the BankWest debt and retain the contingency sum, and this also has been done.

The proceedings and the question for separate decision

- [30] These proceedings were commenced on 24 September 2010. The liquidators of NL16 (who were also parties to the Deed in that capacity) and NL16 claimed against Trust Company a declaration that the guarantee and indemnity dated 14 May 2009 and the mortgage dated 29 January 2010 were of no force or effect. The plaintiffs also sought a declaration that NL16 “is entitled to the surplus proceeds of sale of Sydenham Village”. The Claim also sought other relief. The statement of claim pleaded grounds upon which NL16 was said to be entitled to avoid the guarantee and the mortgage. It also pleaded that Trust Company had no entitlement to the surplus proceeds of sale of Sydenham Village. Alternatively, it sought an order that Trust Company was liable to compensate NL16 in the amount required to discharge the guarantee and the mortgage.

- [31] By its original defence, Trust Company defended these claims and also brought a counterclaim asserting its entitlement to the surplus. It pleaded that as at 28 October 2010, \$10,701,903.07 was due and owing to it by NL7, that payment had been demanded on that day, that NL16 failed to comply with the demand and that NL16 was indebted to Trust Company in that amount as at 28 October 2010. Trust Company pleaded the terms of the mortgage and pleaded in conclusion that “the surplus proceeds of sale of Sydenham Village are secured to the Defendant under the NL16 Mortgage.” It sought a declaration to this effect by counterclaim and also a declaration that it is entitled to the surplus proceeds of sale. The pleadings were subsequently amended. Following the contentions exchanged in correspondence about the effect of the voting that occurred at the meeting on 5 July 2011, Trust Company filed a second further amended defence on 15 September 2011. It pleaded by way of amendment that upon the sale of Sydenham Village by the receivers, Trust Company was entitled to the surplus proceeds of the sale. It pleaded the terms of the Undertaking which was given by the receivers to facilitate being able to complete the sale. It also pleaded the terms of the Deed and asserted in conclusion that:

- “(a) the surplus proceeds from the sale of Sydenham Village are the property of the Defendant, but are held on trust in the Allens Arthur Robinson Trust Account pending the resolution of these proceedings and otherwise pursuant to the terms of the Deed; and
- (b) the Defendant is entitled to be paid, in its own right, the surplus proceeds from the sale of Sydenham Village that are held on

trust in the Allens Arthur Robinson Trust Account, plus any interest that has accrued on this amount.”

- [32] By their second further amended answer, the plaintiffs denied that the Discharge and the Undertaking had the effect contended for by Trust Company and contended that after the Discharge was registered on or about 2 July 2010, and to the extent that the mortgage was valid, that mortgage continued in effect except as a security over Sydenham Village. The plaintiffs pleaded that, on the proper construction of the Deed, the balance of the surplus from the sale of Sydenham Village which was paid into the AAR Trust Account was not paid into that account as Trust Company’s absolute property but was paid by way of preservation of the balance pending the resolution, whether by agreement or determination by the Court, of the claims made with respect to it in this proceeding, including the claim of Trust Company to be entitled to it pursuant to the mortgage.
- [33] The plaintiffs pleaded facts in relation to the convening and conduct of the meeting that was held on 5 July 2011 (about which there is no dispute). They pleaded in paragraph 38 of their second further amended answer that, on the basis of those facts, if Trust Company’s mortgage was otherwise valid and enforceable prior to the July meeting (which the plaintiffs denied), then:
- (a) Trust Company is taken, by reason of Regulation 5.6.24(3) of the *Corporations Regulations 2001* (Cth), to have surrendered the mortgage; and
 - (b) Trust Company has no entitlement to the surplus proceeds of sale of Sydenham Village.
- [34] In its reply filed on 28 September 2011, Trust Company denies these allegations on the ground that Regulation 5.6.24(3) did not operate as a result of the circumstances pleaded by the plaintiffs because:
- (a) the NL16 Mortgage had already been discharged at the completion of the sale of Sydenham Village; and
 - (b) the surplus proceeds are the property of Trust Company, but held on trust in the AAR Trust Account pending the resolution of these proceedings and otherwise pursuant to the terms of the Deed.

In the alternative, Trust Company pleaded that it should not be taken to have surrendered the NL16 mortgage as its omission to value its security arose from inadvertence.

- [35] The order made pursuant to r 483 relates to the trial of allegations in specified paragraphs of the second further amended defence, the second further amended answer and the reply to that answer. The resolution of those allegations does not depend upon disputed questions of fact. The essential issue for preliminary determination is whether (as the plaintiffs contend) Trust Company’s mortgage was surrendered on 5 July 2011 by operation of Regulation 5.6.24(3) or whether (as Trust Company contends) it was discharged at an earlier time. The separate and preliminary trial of that issue does not include a consideration of the claims for relief contained in the statement of claim or the matter pleaded in the alternative in paragraph 4(b) of Trust Company’s reply, namely that if, contrary to its primary

position, Regulation 5.6.24(3) applies, it should not be taken to have surrendered the mortgage as its omission to value the security arose from inadvertence.

- [36] Simply stated, the plaintiffs contend that Trust Company's claim to the proceeds rests on its mortgage, and that its security in that regard was surrendered by operation of Regulation 5.6.24(3) (subject to the Court being satisfied that the omission to value the security arose from inadvertence). Trust Company contends that its mortgage was discharged long ago by the Discharge that it granted, and that its interest in the proceeds rests upon the Undertaking which was necessary to recognise its interest in the surplus proceeds in circumstances in which it gave the Discharge.

Discussion

- [37] The plaintiffs admit that "to facilitate the receivers and managers being able to complete the sale of Sydenham Village, the Defendant agreed to provide a discharge of the Defendant's Mortgage in respect of the Sydenham Village at completion, on condition that the receivers and managers provide the Undertaking", but plead that the Discharge that Trust Company agreed to provide was "a discharge in respect of Sydenham Village and not a discharge of the Defendant's Mortgage in its entirety." This plea goes to the heart of the issue for separate determination. Trust Company frames the issue as whether the security interest constituted by the mortgage document was discharged prior to the sale by the receivers, or whether the security interest continued in some modified form. It emphasises that one is concerned with the maintenance of what it describes as a "security interest" and not with whether the mortgage document had some continuing operation—for instance, with respect to personal liability for a debt in respect of which security had been discharged. The mortgage given to Trust Company contained a personal covenant to pay certain moneys in full, and there is no suggestion that the Discharge operated to discharge this personal covenant. In that regard, Trust Company submitted that it was not helpful to speak in terms of the mortgage being discharged "in its entirety". The focus is on the discharge of the security, not upon the discharge of the mortgage in some broader sense.
- [38] Next, Trust Company emphasised that the land was the only relevant property which existed at the time of the Discharge. The sale had not been completed and there were no proceeds. Trust Company's counsel posed the question: if an encumbrance or charge survived beyond the point of the discharge, to what property then in existence, or to come into existence, did it attach? Counsel in effect answered the question by submitting that because the Discharge was of "the property" defined in the mortgage (namely the land) and this was the only property which existed at the time of the Discharge, and because the Discharge did not seek to preserve the mortgage so as to give Trust Company a security interest in proceeds which had yet to come into existence, it was to be left with no security interest in the proceeds and had to protect its position by obtaining the Undertaking.
- [39] Trust Company submitted that regard must be had to the circumstances in which the Discharge was given, namely on the condition that the receivers and managers provide the Undertaking. It submitted that it needed the Undertaking because it was giving up its security and therefore its rights as a secured creditor to enforce its security in respect of the land, and the rights it enjoyed as a second mortgagee in

respect of the proceeds of sale in the event that the land was sold by the first-ranking mortgagee.¹

- [40] The plaintiffs answered the rhetorical question posed by Mr Kelly SC by submitting that the mortgage attached to the surplus proceeds of sale, and that this answer is given by the terms of the mortgage itself. They also pointed to authorities which establish the general principle that where mortgaged property is sold, the security applies to the proceeds.² This has the consequence that a sale does not alter the mortgagee's status as a secured creditor.³
- [41] The plaintiffs rely upon cl 1.2 of the Memorandum of Common Provisions of the mortgage which appears in the following context:

“1.1 As the owner of the property, you mortgage the property as security for payment of the secured money. (*The secured money is defined in clause 5.*)

1.2 **As security for payment of the secured money, you also mortgage:**

(a) **any proceeds from a sale or other disposal of the property; and**

(b) any compensation money you receive from a government body concerning the acquisition of, or loss or damage to, the property.” (emphasis added)

Clause 1.2(a) is said to reflect the position under the general law.

- [42] Viewed against the provisions of cl 1.2 and the general principle that where mortgage property is sold, the security applies to the proceeds, the plaintiffs submit that clear words would be required to conclude that the Discharge extended beyond the land to the proceeds of sale.
- [43] Trust Company does not contest the principles stated in the authorities, but submits that they, and cl 1.2 which reflects them, do not apply in a case in which the mortgage has been discharged. It submits that the cases cited by the plaintiffs proceed on the basis that the relevant property is mortgaged, and that any assumption that the mortgage also applies to the proceeds of sale, does not govern this case because it is not a case in which mortgaged property was sold. The

¹ As to the obligation of a first mortgagee in respect of a surplus, see *Charles v Jones* (1887) 35 Ch D 544 at 549; *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269 at 287-8, 290, [2009] HCA 44 at [35] and [49]; *Lloyds Bank NZA Ltd v National Safety Council of Australia Victorian Division (in liq)* (1993) 2 VR 506 at 511, 514; *Residential Housing Corporation v Esber* [2011] NSWCA 25 at [123]-[144]; *St George Bank Ltd v Perpetual Nominees Ltd* [2011] 1 Qd R 389 at 398, [2010] QSC 57 at [47]-[50].

² *Re Murrell; Ex parte Official Trustee in Bankruptcy* (1984) 57 ALR 85 at 91, [1984] FCA 314 at [15]; *Re Miles; Ex parte National Australia Bank Ltd* (1988) 20 FCR 194 at 200, [1988] FCA 409 at [33]; *AVCO Financial Services Ltd v Commonwealth Bank of Australia* (1989) 17 NSWLR 679; *Re Kimberley NZI Finance Ltd v AR Barr Investments Pty Ltd* [1990] FCA 54 at [19]; *Re S & D International Pty Ltd (in liq)* [2009] VSC 225 at [159]; *La Trobe Capital & Mortgage Corporation Ltd (No 2)* [2009] NSWSC 1372 at [33].

³ *Aircon Heating and Airconditioning Pty Ltd (in liq) v Crane Distribution Ltd* [2006] VSC 76 at [48]-[51].

mortgage had been discharged prior to the settlement. Clause 1.2 reflected the general law, and was not concerned with the situation where the mortgage had been discharged prior to settlement in respect of the only property to which the mortgage applied at the time of discharge. Clause 1.2 did not apply where the mortgage had been discharged before the property was sold and any proceeds from the sale came into existence.

- [44] Trust Company also submits that clear words would be required to suppose that a mortgage, having been discharged in respect of the only property to which it could then attach, survived in some modified form to provide security in respect of future property, or was somehow revived once the proceeds of the sale of the unencumbered property came into existence.
- [45] The parties' submissions direct attention to the terms of the Discharge and the context in which it was given, namely on condition that the receivers and managers provide the Undertaking. The terms of the Discharge indicate that Trust Company discharged the land from the moneys secured by the mortgage. It did not state that the Discharge applied to any security in respect of any proceeds from the sale or other disposal of the property. However, the absence of such words is understandable for two related reasons. First, at the time of discharge there were no proceeds of sale. Secondly, the proceeds of sale were the subject of the contemporaneous Undertaking.
- [46] Further, the absence of some more broadly expressed form of words to the effect that the mortgage was discharged "in its entirety" is consistent with an intention to discharge only the property as security for the moneys secured by the mortgage, and to ensure that obligations to pay money in accordance with a covenant in the mortgage were unaffected by the Discharge.
- [47] Regard must be had to the circumstances in which the Discharge was given, and in particular the provisions of the Undertaking, as that Undertaking was the condition upon which the Discharge was given. Viewed in isolation, the terms of the Discharge are not entirely clear as to whether:
- (a) it was intended to discharge the only property to which the security attached at the time it was given and it was not intended that the mortgage should attach at some future time to future property, namely the proceeds of sale; or
 - (b) the Discharge was limited to a discharge of the land, being the only discharge required to allow the property to be sold free of encumbrances and to enable the receiver, as agent of the borrower, to complete the sale and give clear title to the purchaser.

Absent the contemporaneous Undertaking, the latter interpretation would probably be preferred.

- [48] As to the Undertaking, the plaintiffs submit that it was provided simply to ensure that the surplus funds were not dealt with without the agreement of the parties who were asserting an interest in them or an order of a Court of competent jurisdiction. Trust Company submits, on the other hand, that the Undertaking was needed because it, Trust Company, was giving up a security that it had and its rights to

enforce that security. It submits that if it had retained a security over the settlement proceeds, there would have been no need for the Undertaking.

- [49] The Undertaking, by its recitals, identified that its purpose was to allow Trust Company to consider whether BankWest's registered charge and registered mortgage secured any indebtedness of the borrower (NL16) to BankWest other than the borrower's indebtedness to BankWest in respect of two facilities described as the Nolimit 16 Facilities in priority to Trust Company's registered mortgage. In consideration of the receivers giving the Undertaking to Trust Company, Trust Company agreed to give the receivers a discharge of its mortgage to enable the borrower to complete the contract of sale. The terms of the Undertaking provided for the payment from the purchase price of certain costs and expenses incurred in respect of the sale of the land, the payment of principal, interest, costs and charges owing by NL16 to BankWest in respect of the Nolimit16 Facilities and for payment of the receivers' remuneration, and all liabilities, costs and expenses incurred or to be incurred by the receivers in their capacity as receivers and managers of the property, rights and undertaking of the borrower. After making the payments contemplated in subparagraphs 3(a) to 3(c), the receivers were authorised to pay to a nominated firm of solicitors any funds held by them after making those payments, with the funds to be held "in their trust account and not to be released without the written consent of BankWest and Trust Company, or by order of a Court of competent jurisdiction."
- [50] The Undertaking was given in circumstances in which BankWest did not exercise its power of sale as registered mortgagee, in which event any surplus proceeds would have been held by it subject to an obligation as trustee or some other form of fiduciary obligation. Instead, Trust Company discharged its mortgage to enable the registered mortgagor as vendor to complete the contract of sale dated 11 June 2010. The Undertaking contemplated a possible dispute concerning the indebtedness of the borrower to BankWest in respect of which BankWest had priority by virtue of its first-ranking mortgage. Once the registered mortgage was discharged, the issue was not one about the rights of BankWest and Trust Company under their respective mortgages in respect of the property over which their mortgages were registered. It was what their rights *had been*, and whether BankWest's registered mortgage had enjoyed priority over Trust Company's registered mortgage in respect of any indebtedness of NL16 in addition to the "Nolimit16 Facilities".
- [51] The net proceeds after the payments contemplated by subparagraphs 3(a) to 3(c) were to be paid to solicitors "to be held in their trust account". The funds were to be held pending agreement between BankWest and Trust Company, or a Court order which resolved the issue of what had been the extent of BankWest's priority in respect of its registered securities. Depending on the resolution of that issue, BankWest might establish an entitlement to some or all of the funds held in the trust account. The resolution of the matter by agreement or Court order might instead wholly favour Trust Company, in which event Trust Company would be paid the funds held in the trust account. In the meantime, there was scope to pay amounts to Trust Company. As matters transpired, Trust Company and the receivers agreed upon an arrangement which included the making of a partial disbursement of \$1,663,416.20 by the receivers to Trust Company, with the balance to be held by the receivers pursuant to the Undertaking, pending the sale by the receivers of property owned by Nolimit10 Pty Ltd, to which the receivers were also appointed by BankWest. However, before any payment pursuant to this arrangement was made,

the first plaintiffs in their capacity as liquidators of NL16 disputed Trust Company's entitlement to the proceeds. This episode serves to illustrate the kind of process contemplated by the Undertaking, whereby the proceeds of sale, after making the payments contemplated by subparagraphs 3(a) to 3(c) were to be held in a trust account, and not released without a Court order or the written consent of the only two parties with an apparent interest in the proceeds, being the former registered mortgagees of the property.

- [52] The Undertaking did not create a substitute form of security to be held by Trust Company or, by its terms, recognise that the funds held in the solicitors' trust account were subject to a security that had been granted by the mortgage that was to be discharged upon the giving of the Undertaking.
- [53] The terms of the Undertaking indicate that if Trust Company had no entitlement to the funds because BankWest would have had priority over Trust Company's registered mortgage to an extent that entitled it to all of the net proceeds of sale, then there would be no obligation to account to Trust Company in respect of the funds held in the solicitors' trust account. If, however, Trust Company did establish that BankWest's registered securities did not secure any indebtedness other than NL16's indebtedness in respect of the Nolimit16 Facilities, then the Undertaking contemplated that there would be an obligation to account to Trust Company, and that the mechanism for this was the funds held in the solicitors' trust account to be released upon the written consent of BankWest and Trust Company, or by a Court order.
- [54] In simple terms, the net proceeds were to be held on trust pending resolution of the priority issue. This was the mutual understanding of the parties who negotiated the granting of the Discharge in exchange for the Undertaking. The receivers' representative on 22 June 2010 communicated this to Trust Company's representative and to the solicitors who were to hold the net proceeds in their trust account. He confirmed that Trust Company was agreeable to the receivers' request to provide the required discharges "on the basis that any surplus is held on trust pending verification of priority claims." This mutual understanding of the basis upon which the surplus funds were to be held is consistent with the terms of the Undertaking. The terms of the Undertaking do not reflect an intention that the funds to be held in the solicitors' trust account were the subject of securities held by BankWest and Trust Company by virtue of their respective registered mortgages. Instead, it was *because* Trust Company's mortgage was being discharged prior to settlement that it was necessary to protect its interests in the form of the Undertaking.
- [55] I accept Trust Company's principal submission that the Discharge should be construed in the circumstances of the contemporaneous Undertaking and the terms of that Undertaking, and that if the Discharge had preserved Trust Company's security with respect to the proceeds of sale, then the Undertaking would not have been sought or given. It was because Trust Company was prepared to discharge the only property over which it held security that it became necessary to be given the protection that the Undertaking gave it.
- [56] The resolution of the issues raised for separate determination depends upon the meaning and effect of the Discharge and the Undertaking which was given as a condition for the Discharge. The resolution of the issues does not depend upon the

content of the Deed that was subsequently entered into only after the liquidators asserted a claim that the Guarantee and Indemnity and the Mortgage granted by NL16 were of no force or effect.

- [57] I accept the plaintiffs' submission that the Deed was a convenient means of preserving the net amount pending the determination of the competing claims in the proceedings, including Trust Company's claim to the net amount. The Deed did not expressly purport to alter the parties' rights. Trust Company's claim to the Net Amount, as then formulated, was identified in the Deed, and cl 2.4(b) of the Deed expressly stated that the holding of the Net Amount in AAR's trust account was "without admission" as to the claim and counterclaim and "without prejudice" to any rights in respect of the Net Amount. In that context, the language in cl 2.4(a) — that the Net Amount (and any accretions to it) would be held in AAR's trust account "to the account of or in the name of" Trust Company—did not involve a recognition that the net funds were the property of Trust Company. The purpose of the Deed was to preserve a fund, and the Net Amount was to be deposited into AAR's trust account as a means of preserving that Net Amount pending a resolution of competing claims with respect to it.
- [58] In the course of argument, Senior Counsel for Trust Company made its position clear in relation to the Deed. He acknowledged that Trust Company was not submitting that the Deed changed any pre-existing rights. The Deed was an agreement to preserve funds, and the entitlement of Trust Company to the funds depended upon the Discharge and the Undertaking.
- [59] I agree with the parties concerning the operation of the Deed. At the time the Deed was agreed, Trust Company had pleaded its entitlement to the surplus on the basis of the Mortgage and its subsequent demand for payment dated 28 October 2010 pursuant to the Deed of Guarantee. Its original defence pleaded in a conclusionary paragraph that the surplus proceeds of sale were secured to it under the Mortgage. This assertion did not establish that it had a security over the surplus proceeds of sale, and the Deed did not recognise any such security. The Deed was entered into without prejudice to any such claim. It is interesting that Trust Company once expressed its claimed entitlement to the surplus proceeds of sale in terms of the surplus being secured to it. However, by amendment it has now placed the Undertaking at the forefront of its claim to the surplus, and also pleaded the terms of the Deed.

Conclusion

- [60] I conclude that Trust Company's security was discharged by the Discharge that it granted dated 23 June 2010.
- [61] I conclude that the Discharge was granted on condition that the receivers and managers provide the Undertaking. This Undertaking was given and, as a result, the security granted by NL16 was discharged. The surplus proceeds of the sale were held by the receivers pursuant to the Undertaking dated 23 June 2010.
- [62] Because Trust Company's security had already been discharged, Regulation 5.6.24(3) of the *Corporations Regulation 2001* (Cth) did not operate as a result of the admitted circumstances pleaded in paragraphs 33 to 37 of the plaintiff's second further amended answer to the defendant's amended counterclaim.

- [63] The surplus proceeds from the sale of Sydenham Village are held on trust in the Allens Arthur Robinson Trust Account pending the resolution of these proceedings and otherwise pursuant to the terms of the Deed.
- [64] I will hear the parties in relation to the form in which the separate questions should be answered, and in relation to the question of costs.