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DIGGING UP *MOSS* IN THE ANTIPODES (MONIES OWING GUARANTEES)

This article explores the dangers of using words like "due and owing" in a guarantee when the debtor becomes bankrupt and is discharged. Despite statutory protection aimed at keeping the liability of the guarantor alive the words may be viewed as releasing the guarantor from liability. This article explores the interpretation and application of *Re Moss; Ex parte Hallett* in Australia, New Zealand, Hong Kong and how to avoid the problem in the first place.

I. INTRODUCTION

IT is not uncommon for guarantees to include words like the following:

> ... the guarantor hereby guarantees on demand to pay to the bank all moneys & discharge all obligations & liabilities whether the actual or contingent now or at any time hereafter *due or owing* to the bank by the customer ...[1] (bold added)

This article explores the issue of whether guarantees containing such words are potentially fatal in the event of the discharge from bankruptcy in the case of an individual, or in the event of insolvency and dissolution of a company. The governing case is the old English case of *Re Moss; Ex Parte Hallett.*[2]

II. THE DISTINCTION BETWEEN MADE BANKRUPT AND BEING DISCHARGED FROM BANKRUPTCY

If the principal debtor is adjudicated bankrupt then, in the absence of any special wording, the guarantor is still liable since the debt is still due and owing. The creditor must lodge a proof of debt with the trustee rather than commencing a legal action against the debtor. When the bankrupt is dis-

[1] Lingard, *Bank Security Documents* (2nd Ed, 1988), at 328.
[2] [1904-7] All ER 713; [1905] 2 KB 307.

charged from bankruptcy, although it means that he or she is personally free from debts, it does not logically follow that creditor's rights against the bankrupt's assets cease.

The co-extensiveness of the surety's obligation has been commented on as follows:

> (it) ... does not extend to the discharge of the principal debtor's personal liability by *operation of law* when the discharge is for the purpose of liquidating his affairs or transforming the rights of the creditor against him into rights against or in respect of his assets. The doctrine should be understood to look rather to a continuance of a just claim in the creditor to receive payment in respect of the principal debtor's obligation than to the latter's relief from actual personal liability.[3] (bold added)

A. *The Effect of Statute*

Since one of the main reasons for taking a guarantee is to protect the lender in the event of the bankruptcy of the borrower it is hardly surprising that the Australian Bankruptcy Act 1966 takes the common law stance that discharge from bankruptcy of the borrower does not result in the surety being released. Section 153(4) accordingly provides as follows:

> The discharge of a bankrupt from a bankruptcy, does not release from any liability a person who, at the day on which the bankrupt became a bankrupt
>
> (a) ...
>
> (b) was a surety or in the nature of a surety for the bankrupt.

This derives from the forerunners of the British Insolvency Act 1986 which also provides along similar lines in section 281(7)

> Discharge does not release any person other than the bankrupt ... from any liability as surety for the bankrupt

Other countries which have inherited the British law tradition have similar provisions. Singapore law, for example, in section 127 (6) of the Bankruptcy Act 1995 provides as follows:

3 Dixon J, *McDonald* v *Dennys Lascelles Ltd* (1933) 48 CLR 457, at 480.

> Discharge shall not release any person other than the bankrupt from any liability (whether as partner of co-trustee of the bankrupt or otherwise) from which the bankrupt is released by the discharge, or from any liability as surety for the bankrupt or as a person in the nature of such a surety.

In Malaysia section 35(4) of the Bankruptcy Act 1967 provides as follows:

> An order of discharge shall not release any person who at the date of the receiving order was a partner or co-trustee with the bankrupt, or was jointly bound, or had made any joint contract with him or any person who was surety or in the nature of a surety for him.

Likewise in Hong Kong section 32(4) of the Bankruptcy Ordinance (Cap 6) expressly provides that the discharge of a bankrupt does not affect the liability of any person who, at the date of the receiving order, was a surety for him.

The similarity of wording and the relative paucity of cases on the interpretation of the above sections mean that Australian and New Zealand cases have direct relevance to these jurisdictions.

The starting point in all of this is the rather obvious point that the statutory provision has to be read in the light of the wording of the guarantee. The idea has been expressed as follows:

> if the context clearly provides that the liability of the guarantor shall be released if the principal becomes bankrupt, this provision is binding, but in that case the guarantor is released, not by the effect of the discharge, but because his liability is so limited by the terms of the contract itself.[4]

B. *The Interpretation of the Word "Due" when the Debtor has been Discharged*

How does one interpret language in a guarantee like "monies due and owing" when the principal debtor has been discharged?

In the English case of *Re Moss*; *Ex parte Hallett*[5] the Court had to decide when a debtor had been discharged from bankruptcy whether a surety was

[4] Deane, Bohringer & Fernon, *Mc Donald*, *Henry & Meeks's Australian Bankruptcy Law & Practice* (4th Ed), at para 823.

[5] *Supra*, note 2.

still liable on a covenant under which the surety was to pay the creditor "interest thereon so long ... as any principal money remains due ..."

Darling J made the following point:

> In order to decide that question one must look at the language of the deed (*ie*, the guarantee). The covenant of the appellant (*ie*, the surety) was to pay interest on the principal sum. "So long after" the day fixed for payment "as any principal money remains due under these presents." It is clear, therefore, that if no principal money remains due the appellant is under no liability to pay interest to Cooke, and the question therefore is whether after the bankruptcy, any principal did in fact remain due. It is admitted that no action would lie against the bankrupt, but it is argued that the principal money nevertheless remains due even after he has obtained his discharge. *Due from whom? It could only be due from the bankrupt and ex hypothesis he has been discharged from all liability to pay the principal money. In my opinion, money can only be said to be due in a legal sense when it can be recovered in an action, and it is impossible to say that there can be anything due under this security when no money can be recovered by any legal process. If there is no principal money due, it follows that there is no interest payable.*[6] *(Emphasis added)*

This case has often been criticised as being decided on a fine semantic point;[7] and judges have valiantly sought to distinguish it; yet, on the facts of the case, there seem to be no authorities that say it is wrong.

C. *New Zealand Cases*

The case of *Re Moss* has been followed in a number of New Zealand cases, namely, *Perrott* v *Newton King*[8] and *Quainoo* v *NZ Breweries.*[9] These cases warn of the danger of using words like "owing" or "due" in a guarantee and countenance the possibility that the use of such words in a guarantee may allow the release of the guarantor in the event of the debtor's discharge from bankruptcy (in the case of an individual) or the dissolution of a company.

6 *Supra*, note 2, at 313.

7 *Eg,* Low Kee Yang, *The Law of Guarantees in Singapore and Malaysia* (1992), footnote 47 at 133.

8 *Perrott* v *Newton King* [1933] NZLR 1131.

9 *Quainoo* v *NZ Breweries* [1991] 1 NZLR 161.

D. *Confusion Regarding Principal and Interest*

There appears to be a great deal of confusion regarding the interpretation in *Re Moss* of the words "due", "owing" in the guarantee in regard to the principal debt and interest.

Subsequent cases and commentators appear to make some distinction. Before exploring these it is worthwhile reiterating that in *Re Moss* the surety had *only* covenanted to pay *interest* on the debt – he did not undertake to pay the principal debt. The *ratio decidendi* appears to be that on the debtor's discharge from bankruptcy if the principal debt is no longer due then any undertaking by a surety to pay interest contingent on this ceases also. However, there is no logical reason why, if the surety covenants to pay the principal and the interest and the covenant is dependant on the proposition that this is payable only as long as the principal debt remains "due" or "owing", the surety would also not be discharged. The issue did not have to be decided in *Re Moss* since the covenant related only to paying interest.

In the New Zealand case of *Perrot* v *Newton King Ltd* the guarantee related to payment of interest while the principal debt remained due. The relevant part of the guarantee provided:

> the guarantor hereby agrees with the mortgagees that if any half-yearly payment of interest or part thereof payable as aforesaid shall at anytime while any money remains owing on the security of the said memorandum of mortgage be in arrear or unpaid for the space of fourteen days after any of the days whereas the said interest shall be payable in terms of the said memorandum of mortgage the *guarantor will forthwith pay such interest or part thereof* as the case may be to the mortgagees[10] (bold added)

The court followed *Re Moss* and decided that, despite the New Zealand equivalent of section 153(4) of the Australian Bankruptcy Act, this liability terminated on the debtor's discharge from bankruptcy since the word "owing" indicated a clear intention to release the guarantor. The terms of the guarantee in *Perrot* v *Newton King* were thus on all fours with those in *Re Moss.*

In the New Zealand case of *Quainoo* v *NZ Breweries* the court emphasised the importance of properly construing the guarantee. Hardie Boys J summarised the position in NZ as follows:

[10] *Supra*, note 8, at 1134.

> As has been made clear in all the cases, the question is always one of construction of the particular contract in issue. Section 116 of the Insolvency Act expressly provides that the bankruptcy does not of itself release a guarantor. It will do so only if the terms of the guarantee so provide. In New Zealand a guarantee of the payment while the principal remains "*owing*" is likely to be construed so as to terminate on discharge from bankruptcy, following *Perrott's* case. There is no reason to regard the position as being different upon the dissolution of a company. The same may be so when the guarantee speaks of the principal not as "*owing*" but as "*due*".[11] (bold added)

E. *Australian Cases*

One of the key cases in Australia is *Jowitt* v *Callaghan*.[12] The learned authors Phillips & O'Donovan in the *Modern Contract of Guarantee*, make the following points about the New Zealand decisions:

> In *Jowitt* v *Callaghan Jordan CJ* doubted the correctness of this result. The Chief Justice took the view that the authorities certainly could not be applied so as to relieve the guarantor from liability for all the principal sum where the guarantor takes the form of guaranteeing payment of what might be "due" or "owing" because this would be contrary to the provisions in the Bankruptcy Act (now section 153(4)) providing for the continuation of the liability of the guarantor despite the discharge of the principal. This means that a guarantor for a principal sum that "remains owing" is not released by a discharge in bankruptcy from liability for all the principal sum. Yet his Honour did reluctantly acknowledge, in accordance with the New Zealand view, that the decisions may be applicable in relation to a guarantee of the payment of interest on so much of the principal debts as may be "due" or "owing" because the use of these words shows an intention that the continued existence of a personal obligation on the part of the debtor to pay the principal sum shall be a condition of the guarantor's liability to pay interest after the date of discharge. Thus the decision in *Perrott* v *Newton King Ltd* may be good law in Australia.[13]

[11] *Supra*, note 9, at 171.
[12] *Jowitt* v *Callaghan* (1938) 38 SR (NSW) 512.
[13] Phillips & D'Donovan, *Modern Contract of Guarantee* (3rd Ed, 1996), at 316.

The learned authors seem to be saying that if the guarantee uses words like "due" or "owing", the surety will still be liable in regard to the principal debt if the debtor is discharged from bankruptcy but that if the guarantees only covers an engagement to pay interest then the surety will not be liable. With respect it is difficult to see how the authors necessarily arrive at these conclusions.

Jordan CJ in *Jowitt's* case comments, in general,

> ... a particular contract may by its language indicate that it is intended to guarantee payment only if such interest as may be legally exactable from the debtor by the ordinary process of law, or, on the other hand that it is intended to promise payment of any interest which is not paid by a particular person whether it ever becomes legally exactable from him or not. In either case effect will be given to the special terms of the contract.[14]

He continues:

> ... cases such as *In Re Moss; ex parte Hallett* must be based on the view that where a guarantor guarantees payment of interest only on so much of the principal debt as may be "due" or "owing" the use of these words shows an intention in the parties that the continued existence of a person's obligation on the part of the debtor to pay the principal shall be a condition of the guarantor's liability to interest, in the same way that the continued existence of a lease is a condition of the liability of a guarantor of rent to pay future rent.[15]

However, Jordan CJ never dismissed *Re Moss* as being wrong since it was not crucial to his decision for the wording of the Guarantee and the factual solution in *Jowitt* v *Callaghan* were completely different, namely:

> (i) the guarantor
>
> covenanted that if the mortgagor should fail to pay the interest ... the guarantor would pay such interest as should be so in arrears and unpaid.[16]

[14] *Supra*, note 12, at 521.
[15] *Ibid*, at 522.
[16] *Ibid*, at 514.

It was never predicated on the basis that payment of interest was only on so much of the principal debt as may be due or owing; and

(ii) the borrower (mortgagor) in *Jowitt's* case, although he was made a bankrupt, had not been discharged from bankruptcy. Jordan CJ makes the point that

> ... whatever may be the effect of an order of discharge the making of a sequestration order, and the consequent restriction of the creditor to a right of proof instead of a right of action do not prevent the bankrupt's debts from continuing to be due.[17]

His Honour then distinguished *Re Moss* by observing that it was unnecessary to deal with the point for determination of the question before the court. In *Re Moss* the crucial words in the guarantee were to pay interest on the principal sum "so long after" the day fixed for payment "as any principal money remains due under these presents".[18] The wording (and the factual situation) were quite different from that of the guarantee in *Jowitt's* case. Hence Jordan CJ was not constrained by *Re Moss*.

III. Protective Clauses – By Operation of Law

If the language of a guarantee avoids the use of words like "moneys due, payable, or owing" by the debtor, or guaranteeing the "repayment obligations of the principal debtor", and replaces such language with a simple proposition that the guarantor's obligation is expressed to be conditional upon "*repayment*" of the debt, then a discharge from bankruptcy will have no effect on the guarantor's liability because, even after the discharge, there has been no repayment.[19]

The following are illustrations of cases where by operation of law, the principal debtor's obligation had been discharged or compromised, but the guarantor was still liable:

(a) *Re Fitzgeorge; Ex parte Robson.*[20] This was a case where the principal debtor company went into liquidation and was subse-

[17] *Ibid*, at 522.
[18] *Supra*, note 2, at 314.
[19] *Supra*, note 13, at 317.
[20] [1905] 1 KB 462.

quently dissolved. The guarantee was expressly limited to the payment of interest only. Bigham J said:

> It is said that, because the principal debt is gone, therefore the liability under guarantee to pay the interest on the debenture is also gone. I do not agree with that view. The principal debt is gone no doubt, but not by any act of the creditor. It is gone *by operation of law*. The principal debt will never be repaid, but in my opinion the obligation of the debtor to pay the interest under the guarantee remains.[21] (bold added)

(b) *Ex parte Re Jacobs*.[22] This was a case pursuant to the English Bankruptcy Act 1869, where the general creditors of one Samuel Phillips (who was an acceptor of a bill of exchange), had accepted a statutory deed of composition from him. The issue then was whether the acceptance of the deed of composition from Phillips, the acceptor on the bill of exchange, would discharge the drawer (Jacobs) who was the surety. The court of Appeal said:

> We think that a discharge of a debtor under a liquidation or a composition is really a discharge in bankruptcy by operation of law. Where a creditor voluntarily agrees to a composition by deed or agreement with the acceptor, it is by his act alone that the acceptor is discharged and the position of the drawer altered.[23]

The Court therefore held that because the statutory deed of composition amounted to a discharge by operation of law, the secondary liability of the drawer (Jacob's) under the bill had not been released. The case was also interesting in that the Lord Justices said that once the composition had arisen by operation of law, it would not have mattered even if the particular creditor of the bill had voted in favour of the statutory composition, the discharge of the acceptor by operation of law would in no way discharge the drawer of the bill.

(c) *Commercial Bank of Sydney* v *Gaty*.[24] This was a case where the principal debtor company was placed under official man-

21 *Ibid*, at 464.
22 (1875) LR 10 Ch 211.
23 *Ibid*, at 214.
24 (1979) CLC (CCH) at para 40-539 (p 33, 190).

agement pursuant to the Companies Act 1961 (New South Wales). Section 203B (1) thereof provided:

> Where a company is under official management, no action or proceedings in any court shall except with the leave of the Court ...:

Counsel for the guarantors made the submission, that the prohibition in section 203B in respect of any action against a company during the official management had the result that the guarantors could not during that period be made liable under their guarantee with the bank and, accordingly, that the mortgage, which secured the moneys owing by them under the guarantee to the bank, could not be enforced.

Lee J responded to this proposition with the following:

> The creditor can no longer enforce his rights by action at law, without the leave of the Court, but he can prove his debt before the official manager and require that the official manager observe the provisions (of section 208(5). I am unable to see that any valid distinction can be made between the position of the creditor in the circumstances just referred to and the position of a creditor in a bankruptcy or winding up or composition or scheme within a winding up; or in a scheme of arrangement under section 181 such as was dealt with in *Hill* v *Anderson Meat Industries Ltd* (1971) 1 NSWLR868, by Street J. In each case the obligation of the debtor to pay, although no longer enforceable by the creditor personally against the debtor, is superseded by rights in the creditor against the assets or moneys, as the case may be, of the debtor, and that situation in each case is brought about by the operation of the statute. In my opinion, the rule that bankruptcy, or liquidation, or compositions or schemes within bankruptcy or liquidation, does not discharge a guarantor, can be applied by analogy to the situation here in just the same way that it was applied to a scheme of arrangement under section 181 in *Hill* v *Anderson Meat Industries Ltd* (1971) 1 NSWLR 868.
>
> Accordingly, I am of the opinion that the bank is not precluded during the official management of the company from enforcing the guarantee against the defendants and that, the defendants being liable under the guarantee, the bank may enter into possession of the mortgaged property and eject the defendants.[25]

[25] *Ibid*, at 32, 193 to 32, 194.

A. *Protective Clauses*

Whilst it is common in many modern guarantees that there be a protective clause against matters arising by operation of law,[26] it is submitted that such an inclusion is unnecessary to maintain the liability of the surety. However, such a protective clause should not be confused with other forms of protective clauses which may be necessary to preserve the liability of the surety for the benefit of the lender. Examples of the latter are as follows:

(a) Where there has been a private arrangement between the lender and the principal borrower to compromise a debt;[27] or

(b) where the principal loan contract has been held to be void for whatever reason, and there is a principal debtor clause which renders the guarantor liable as an indemnifier.[28]

B. *Protective Clauses – Private Compromise*

In *Bank* of *Adelaide* v *Lorden*,[29] there was a private debt compromise arrangement between the Bank of Adelaide and the borrower in that, if the sum of £889 10s 5d was paid, then as between the Bank and the debtor, the debt (£12,938) would be treated as settled. However, in the guarantee, there was a protective clause which expressly gave the Bank the right to compound with the borrower without affecting, impairing or releasing the guarantee or the guarantor's liability thereunder.

After the debt had been compromised and settled with the debtor, the Bank then served a demand and sought recovery as against the guarantor. Before the court of first instance, the trial judge held against the bank on the basis that the debt had been compromised. Accordingly, it was found there was no basis for recovery as against the guarantor.

On appeal to the High Court of Australia, the court relied on *Perry* v *National Provincial Bank*,[30] and held that although the debt as between the

[26] See *The Australian Encyclopaedia of Forms and Precedents* (3rd ed) Vol 7, Form 1.1 Cl 3 (3) (k) and (q) and Cresswell, Blair, Hill & Wood, *Encyclopaedia of Banking Law*, E2082.

[27] *Ibid*, cl 3(3) generally and Holden M J, *Law & Practice of Banking* Vol 2 (6th Ed) at 19.51.

[28] *Supra*, note 1, at 329; *Supra*, note 26, clause 6.1 and E2078; and *Supra*, note 27, at 19.44 to 19.46.

[29] (1970) 127, CLR 185. There were two issues, the first was related to the protective clause, and the second was whether there could be any accrual of interest after the debt had been settled *inter parte.*

[30] (1910) 1 Ch 464.

bank and the borrower had been settled, the protective clause as between the bank and the guarantor meant that the parties by agreement deemed the outstanding loan to be still afoot.

Accordingly, the bank was successful in obtaining judgement as against the guarantor.

C. *Discharge by Operation of Law Versus Private Arrangement*

Why is it that a discharge of the debtor by operation of law does not discharge the guarantor, but where there has been a private release of the debtor by the lender (and there is no protective clause), the guarantor is discharged?

The answer has been explained in the Canadian decision of *Montreal* v *McFatridge*[31] which was accepted with approval in *ACCU* v *Pollard*[32] where Legoe J said:

> In that case (*Montreal* v *McFatridge*) the headnote states that the fact that the principal debtor has been declared bankrupt does not release his surety who has previously guaranteed to pay the creditor's debts and liabilities "due or owing" to that creditor. Bankruptcy does not extinguish the debt of the principal debtor, but merely suspends a right of action thereon, and it is the obligation of surety to pay if the debtor cannot. Bankruptcy it is said in that case is 'an outstanding example of such inability to pay and it is the purpose of a guarantee to secure payment in just such circumstances'. I take this from the headnote of that case on page 557. In the course of his reasons Dunfield J at 567 discussed the effect of bankruptcy upon the creditors' rights and the guarantor's obligations. His Honour said:
>
> "For bankruptcy does not extinguish the debt of the principal debtor. Suspending the right of action is a different matter altogether ... This bars the remedy, but it does not extinguish the debt."[33]

Therefore it can be said, that notwithstanding bankruptcy and subsequent discharge from bankruptcy,[34] the debt albeit no longer personally enforce-ability against the debtor, is still "alive". Accordingly, the co-existence of the guarantee remains intact. This explains Dixon J's observation, quoted earlier, that

[31] (1959) 17 DLR (2d) 557.

[32] (1991) ASC 56, 093.

[33] *Ibid*, at 56, 977.

[34] Its equivalent for a corporation is liquidation and subsequent dissolution and *supra*, note 9, at 171.

> the doctrine should be understood to look rather to a continuance of a just claim in the creditor to receive payment in respect of the principal debtor's obligation than to the latter's relief (referring to the surety) from actual personal liability.[35]

However in a private compromise between the lender and the debtor, the debt has been totally discharged: accordingly there is no basis for the continuance of the guarantee unless there is a protective clause in the guarantee preserving the lender's right as against the guarantor.[36]

D. *Protective Clauses – Hong Kong Postscript*

In the Hong Kong case of *Wing On Finance Co Ltd* v *Lam Sou Wing Stephen*,[37] the debtor company was in liquidation, but there is no mention in the judgement that the company had been dissolved. One therefore assumes it was not. Upon the debtor company having gone into liquidation, the lender/creditor sought recovery from the guarantor. The guarantor attempted to rely on *Re Moss*[38] by asserting that after the debtor company had gone into liquidation, any moneys due and owing by the debtor could not be enforced against him as guarantor. Before proceeding with His Honour's reasoning for his decision, clause 7 of the guarantee is worth setting out. It provided:

> The bankruptcy or insolvency of the principal shall not affect or determine the liability of the guarantor under this guarantee but such liability shall continue in full force and effect until you shall have been repaid all moneys due to you from the principal immediately before the bankruptcy or insolvency of the principal.[39]

On the basis of clause 7, his Honour Saied DJ held in favour of the lender/creditor and said:

> Clause (1), as I have said, contained a general guarantee guaranteeing moneys which were already due and owing and moneys which thereafter should become due and owing. It was said that after the moneys now sued for had become due and owing, Auto Engineers Pty Ltd went into liquidation so that thereupon any debt owing by it could not be

35 *Supra*, note 3.
36 *Supra*, notes 29 and 30 and the accompanying main text.
37 1989 – 1 HKC 307; 1989 KC LEXIS 41.
38 *Supra*, note 2.
39 *Supra*, note 37 at [9].

> enforced. On the authority of *Re Moss*, *ex parte Hallet* (1905) 2 KB 307, it was said that thereupon the guarantee ceased to have any application. The case does not support that proposition because the guarantee we have before us applied not so long a debt which has become due and owing continues to be due and owing but whenever any debt becomes due and owing. The debts here sued for did become due and owing. They are therefore covered by the guarantee and the fact that liquidation of the principal debtor supervened is immaterial.[40]

Assuming that the debtor company had not been fully wound up (liquidated and dissolved),[41] his Honour could simply have disposed of the guarantor's defence by relying on the traditional authorities such as *Re Fitzgeorge*,[42] the observations of Dixon J in *McDonald* v *Dennys Lascelles Ltd*[43] and the observations of Dunfield J in *Montreal* v *McFatridge*[44] to the effect that the bankruptcy of a debtor does not extinguish the principal debt. Accordingly the lender/creditor was entitled to look to his guarantor for repayment.

Re Moss could have been simply distinguished on the basis that in the case before him, the debtor company, although in liquidation, had not been dissolved.

If, on the other hand, the debtor company Auto Engineers Pty Ltd had been fully wound up,[45] then his Honour's reliance on *Guthrie* v *Motor Credits Ltd*,[46] and *Bank of Adelaide* v *Lorden*,[47] seems unwarranted because:

(a) *Guthrie* v *Motor Credits* did not deal with the liability of a guarantor when the principal debtor had been discharged from bankruptcy (or, if it was a corporate debtor, if it had been fully wound up); and

(b) *Bank of Adelaide* v *Lorden* was not about the liability of a guarantor based on a protective clause against matters arising by operation of law, rather it dealt with a protective clause in relation to a private arrangement between the lender/creditor and the debtor.

40 *Supra*, note 37, at [26].
41 That is, having been liquidated and subsequently dissolved.
42 *Supra*, note 20.
43 *Supra*, note 3.
44 *Supra*, notes 31 and 32.
45 *Supra*, note 40.
46 (1963) 37 ALJR 167.
47 *Supra*, note 29.

Therefore the basis for his Honour Saied DJ's decision does not seem, with respect, to be fully supported by the authorities he has quoted.

The outcome of the decision is correct if the debtor company had not been dissolved, which means simply that the guarantee was still afoot.

As to his Honour's following proposition, namely

> because the guarantee we have before us applied not so long a debt which has become due and owing continues to be due and owing but whenever any debt becomes due and owing. The debts here sued for did become due and owing. They are therefore covered by the guarantee and the fact that liquidation of the principal debtor supervened is immaterial.[48]

This appears somewhat dubious since, whilst the debtor is still "alive", that is, it is in liquidation but has not been dissolved, it can be said that the debt is still due and owing,[49] therefore a discharge of the debtor by operation of law does not extinguish the debt, and hence the guarantor is still liable.[50] However, to maintain that proposition after the debtor (in the case of a company) has been liquidated and dissolved, would appear to run counter to established authorities.

In *Bank of Adelaide* v *Lorden*[51] which was also relied on, the second issue before the High Court of Australia was, whether the lender/creditor could claim interest on the debt as against the guarantor, based on the protective clause which gave the bank the right to compound with the debtor without affecting, impairing or releasing the guarantor. The court said "no", because as a matter of reality, the debt between the bank and borrower had been compromised and settled. Accordingly, there was no basis for any interest to accrue on a debt that no longer existed. However, once the bank had rendered a demand on the guarantor pursuant to the protective clause, then interest on the sum demand may then accrue, because the guarantee had expressly provided for interest on sums payable by the guarantor.

Applying the court's reasoning in *Bank of Adelaide* v *Lorden* and more importantly in *Russian and English Bank* v *Baring Bro*,[52] once there has been a private arrangement to release the debtor, or the debtor corporation

[48] *Supra*, note 39.
[49] *Supra*, note 17.
[50] *Supra*, notes 20 to 25.
[51] *Supra*, note 29.
[52] (1936) AC 405, at 427 where Lord Atkin said "*the debts of a corporation either to or from it are totally extinguished by its dissolution.*"

has been dissolved, then it is doubtful that one could sustain the distinction as Saied DJ did in *Wing On Finance Co Ltd* v *Lam Sou Wing Stephen* as the basis for the guarantor's liability.[53] As mentioned earlier, the correct and simple answer may lie in the fact that the debtor company had not been dissolved.[54] The transcript of the judgement appears to be silent on this important point.

E. *Principal Debtor Clause – Indemnity*

The *raison d'etre* of the indemnity clause is that, if the lender/creditor cannot enforce its remedy as against the guarantor pursuant to the guarantee, then the lender/creditor can have a "second bite of the cherry" by having in the guarantee a clause which entitles the lender to recover against the guarantor as a deemed principal debtor – the guarantor's obligation is also that of an indemnifier.

The origin of the principal debtor clause was to overcome the lack of capacity (*ie*, infancy) by the borrower in *Coutts & C* v *Browne Lecky and Others*.[55] It then expanded to other forms of legal limitation, disability and including

> any other fact or circumstance and whether known to you (referring to the lender) or not shall nevertheless be recoverable from us (referring to the guarantor as a sole or principal debtor in respect thereof and shall be paid by us on demand.[56]

But the simple fact of the matter is, if one remembers the basic proposition of law that a discharge of the debtor by operation of law will not discharge the surety, that one only needs to avoid the use of words like "moneys due or owing", "moneys payable by the debtor", or "guaranteeing the repayment obligation of the debtor", and make the guarantor's obligations conditional upon "repayment of the debt": a discharge from bankruptcy

[53] *Supra*, note 39. On the other hand, a guarantor's obligation is an exception to the *Russian Bank* case provided the guarantee is not a moneys "due or owing" guarantee. However it would be a contradiction in terms if one were to have a moneys "due" guarantee where the principal debt is released or discharged when the debtor is discharged from bankruptcy (or been fully wound up), and then try to revive the debt by having a protective clause which runs counter to what has been said in the *Russian and English Bank* case.

[54] *Supra*, notes 3, 20 to 25.

[55] [1947] KB 104 and *supra*, note 27, at 19.44 to 19.46.

[56] *Associated Japanese Bank* v *Credit du Nord* (1988) 3 ALL ER 902; and *supra*, note 27, at 19.48 to 19.51.

[57] *Supra*, note 13, at 317.

then will have no effect on the guarantor's liability.[57]

On the other hand, if one uses words like "moneys due" in guarantees, then there is no certainty that a Principal debtor clause, or an indemnity clause will save the situation.

The following is the indemnity clause from *Associated Japanese Bank* v *Credit du Nord*:

> As a separate and independent stipulation we agree that any sums mentioned in Clause (1) hereof which may *not be recoverable on the footing of a guarantee* whether by reason of [a] *any legal limitation* [b] *disability* or [c] *incapacity* on or of the Lessee (referring to the debtor) or [d] *any other fact or circumstance* and whether known to you or not shall nevertheless be recoverable from us as a sole or principle debtor in respect thereof and shall be paid by us on demand.[58] (Bold added)

In the above Indemnity Clause, the conditions precedent to its operation are:

(a) there must be a legal limitation, disability or incapacity on the part of the debtor; and

(b) the debt must "not be recoverable on the footing of (the) guarantee" from the guarantor.

The above clause does not mention bankruptcy or discharge from bankruptcy of the debtor, and even if one were to assume the words "limitation, disability or incapacity" might include bankruptcy or discharge from bankruptcy of the debtor, it does not follow that the bankruptcy or discharge from bankruptcy of the debtor causes the debt to become extinct. On the contrary the principal debt is still in existence.[59]

If the debt is still in existence, then the position at law is clear, the co-existence of the guarantee is still afoot: *Re Fitzgeorge*[60] and *McDonald* v *Dennys Lascelles*.[61] Accordingly, the conditions precedent to the Principal debtor clause or Indemnity clause have not been satisfied so as to enable the principal debtor clause to come into operation. The catch all phrase

[58] *Supra*, note 55, at 914.
[59] *Supra*, notes 31 and 32.
[60] *Supra*, note 20.
[61] *Supra*, note 3.

of "any other fact or circumstance" does not take the matter any further.

The futility of using such words is also well illustrated in the case of *Associated Japanese Bank* v *Credit du Nord*.[62] This was a case where a rogue, Jack Bennet, purported to sell to the plaintiff bank four expensive engineering machines and then to lease them back from the plaintiff bank, receiving around about a million pounds as the sale price. It was a part of the agreement that he should furnish the plaintiff bank with a guarantee from another bank, which was the defendant bank. Both banks believed the machines existed whereas in fact the machines were a figment of the rogue's imagination. The plaintiff bank sought to enforce the guarantee against the defendant bank. The defendant bank successfully argued that the guarantee was void *ab initio* on the basis of mistake. The plaintiff bank then tried to rely on the indemnity clause with the all embracing words "or any other fact or circumstance".

His Honour Steyn J said:

> On behalf of AJB (Japanese Bank) it was submitted that my conclusion as to common mistake cannot apply to AJB's claim under clause 11 of the guarantee. Under that clause AJB seeks to hold CDN (Credit du Nord) as "sole or principal debtor". The question is whether clause 11 applies. For convenience I set out clause 11 again, with numbering, introduced in order to facilitate discussion:
>
> "As a separate and independent stipulation we agree that any sums mentioned in Clause (1) hereof which may not be recoverable on the footing of a guarantee whether by reason of [a] any legal limitation [b] disability or [c] incapacity on or of the Lessee or [d] any other fact or circumstance and whether known to you or not shall nevertheless be recoverable from us as a sole or principle debtor in respect thereof and shall be paid by us on demand."
>
> On the footing that the sums guaranteed are irrecoverable because the guarantee is void *ab initio* for common mistake it was submitted that AJB can recover on the independent stipulation under clause 11 because the recoverability arises from "any, other fact or circumstance and whether known to you or not." AJB asserts that those words are all embracing. Boldly, it was argued that those words are wide enough to impose liability even where the principal transaction, or even the guarantee itself, is voidable for misrepresentation, undue influence or duress by AJB. And it also covers, it is said, the case where AJB

[62] *Supra*, note 55.

> repudiates the principal transactions. *Literally, that may be right but it is so absurd a construction that common sense will not allow it to prevail.* What is the answer? In my judgement one answer is to be found by reading the wide general words in their context, that is as following particular words (limitation, disability and incapability) which all fall within one genus. In the context the general words following the particular words must be read *ejusdem generis*. So interpreted clause 11 can plainly not avail AJB.[63] (Bold added)

IV. SUMMARY

Re Moss[64] is very much a case which depends on the construction of the document. It has been followed in England and widely accepted in New Zealand, but in Australia no case exactly on the point has come before the court for a decision; usually when it has been raised, the debtor has not been discharged from bankruptcy, or the debtor corporation has not been dissolved, so therefore *Re Moss* can clearly be distinguished. *Lorden's* case had a money "due" guarantee, but the debtor in that case did not go into liquidation, so the issue of dissolution never arose. Since the debt had been privately compromised and settled, the Australian High Court therefore held that it was conceptually not possible for a debt that had been settled to accrue interest. This decision is consistent with the approach taken in *Re Moss*, that is, if there is no debt, then there can be no interest accruing, or if there is no debt that is due and payable by the debtor, then there is nothing for the guarantor to pay provided the guarantee has been predicated on the basis of "moneys due".

The protective clauses are useful, but from a strict legal point of view, if the discharge of the debtor has arisen by operation of law, the guarantor is still liable. In such circumstances the protective clause is otiose. The Principle debtor – Indemnity clause may be a useful clause, but if the Lender/Creditor is using a "moneys due" guarantee, then the Indemnity claim may have other uses but still may not save the Lender/Creditor. The moral of the story is that it is far better to avoid the use of words like "moneys due" in the guarantee.

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[63] *Supra*, note 55, at 913-914.
[64] *Supra*, notes 2, 4.

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