[HIGH COURT OF AUSTRALIA.]

E. T. FISHER & COMPANY PROPRIETARY LIMITED AND ANOTHER . . . DEFENDANTS, } APPELLANTS;

AND

THE ENGLISH SCOTTISH AND AUSTRALIAN BANK LIMITED . . . . . PLAINTIFF, } RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF SOUTH AUSTRALIA.

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MELBOURNE, *Oct.* 23, 24.

SYDNEY, *Dec.* 12.

Rich A.C.J., Starke, McTiernan and Williams JJ.

Bankruptcy—Composition—Agreement to pay debt in full—Agreement made for valuable consideration after composition—Validity.

In 1934 a company granted a charge over its assets to a trustee for its creditors and the creditors assented to an arrangement whereby upon payment by instalments by the company to the trustee of a sum sufficient to pay a composition of 12s. 6d. in the £1 the creditors would release the company from the whole of its indebtedness. The company in 1936 obtained a further advance from its bank, one of its creditors, to enable it to pay the trustee the sum necessary to pay the composition. In consideration of this advance, the company granted the bank a new charge over its assets and agreed to pay the bank the full amount of its indebtedness, including the new advance and the balance of its original debt. All creditors, including the bank, received the composition from the trustee, but the other creditors, with one exception, were ignorant of the new arrangement with the bank. In an action by the bank for the balance due under the arrangement of 1936, the company contended that this arrangement was a fraud on other creditors who, in accepting the composition, were ignorant that the bank, another creditor, would receive 20s. in the £1.

Held that the arrangement of 1936 did not involve a fraud on the other creditors, and accordingly the bank was entitled to payment thereunder, because (by *Rich* A.C.J., *McTiernan* and *Williams* JJ.) the transaction was

not contemporaneous with the composition and in 1934 there was no misrepresentation by the bank of its position to the other creditors when the composition was effected; (by *Starke* J.) the transaction was beneficial to the company, the bank and the creditors, as it enabled the company to pay its composition and was not inconsistent with good faith between the bank and the other creditors.

Decision of the Supreme Court of South Australia (*Angas Parsons* J.) varied.

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APPEAL from the Supreme Court of South Australia.

The main shareholder and director of E. T. Fisher & Co. Pty. Ltd., which carried on business in South Australia, was John Ludwig Koch. The company obtained an overdraft from the English Scottish and Australian Bank Ltd., and, on 17th December 1929, to secure this overdraft Koch granted to the bank a registered mortgage over land owned by him. It was provided in this instrument that Koch would pay on demand the indebtedness from time to time of the company and the acceptance by the bank of any composition from the company would not in anywise discharge Koch from any liability under the instrument, nor otherwise affect or prejudice the security. The instrument was stamped to cover advances up to £6,000, but subsequently, on 1st August 1930, Koch executed a further guarantee of the company's indebtedness, limiting his liability by the latter document to £10,500. The company after 1930 found difficulty in paying its debts, and, at a meeting of creditors on 16th December 1931, it was resolved that the business of the company should thereafter be carried on under the supervision of one Ferres. Under the management of Ferres the company was able only to pay off a dividend of one shilling in the pound, and in 1934 it was arranged to place the company again under the direction of the former directors, including Koch. At a meeting of creditors held on 13th July 1934 it was agreed by all creditors, including the bank and the company, that the company was to give to Ferres as trustee for the creditors a charge over all its assets present and future, to secure the payment in full of all the company's debts, the total of which then was stated to be £11,951 7s. 10d., but with the proviso that, if the company paid £7,500 on or before 18th August 1936 by a deposit of £500 and monthly instalments of not less than £250, that sum was to be accepted in full satisfaction of the indebtedness to all creditors. Pursuant to and in the terms of this arrangement, on 3rd August 1934 the company executed a charge over all its assets in favour of Ferres. During the course of negotiations for this charge Koch on 11th July 1934 wrote to the bank as follows: —"The debts due to its creditors by E. T. Fisher & Co. Limited,

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including the E. S. & A. Bank Limited will be secured as you know by a charge to be executed by that company in favour of Mr. L. W. Ferres as trustee for the said creditors. I have already guaranteed payment by the company to the E. S. & A. Bank. This letter is to inform you that the charge about to be given by the company to Mr. Ferres will not prejudice or adversely affect in any way the guarantee given by me to the bank as mentioned above. This guarantee will remain in full force and virtue according to the tenor thereof notwithstanding the fact that there are further operations upon the account at the bank by the company and further moneys lent and notwithstanding that the bank shares the benefit of the charge upon the property of E. T. Fisher & Co. Limited in favour of Mr. Ferres and in due course may receive satisfaction *pro tanto* and participate in the funds to accrue under the charge. Provided always that discharge in full by payment under the said charge shall release me from the guarantee." By April 1936 the company had paid to Ferres for distribution to creditors the sum of £5,667, leaving a balance of £1,833 to be paid before August. The company thereupon arranged with the bank that it should advance the company the sum of £1,833 to pay to Ferres to satisfy the composition, thereby helping to improve the reputation and goodwill of the company amongst its creditors. Accordingly, on 27th April 1936, in consideration of the new advance the company executed a debenture in favour of the bank charging its assets present and future with payment to the bank of all moneys then and thereafter owing by it to the bank. The debenture provided that it should not affect any guarantee held by the bank and that it should be collateral to the security of the guarantee mortgage granted by Koch. The effect of the covenant for payment was that the bank was to receive payment in full, not only of the advance then being made, but also the balance of its original indebtedness after payment of the composition, together with compound interest thereon. On 28th April 1936 the company drew a cheque for £1,825 10s. on the bank and paid it to Ferres as the balance of the composition of £7,500. Ferres on 8th May 1936 distributed the moneys among the creditors, including the bank, which in fact received £1,373 15s. 2d. as its dividend. On 14th May 1936 Ferres executed a full discharge of the debenture charge given by the company to him in favour of its creditors. On 11th May 1936 the overdraft of the company was £7,691 6s. 10d., including the sum of £1,825 10s., the new advance, and was transferred by the bank to a new account known as "No. 2 account." It was agreed that the company should keep down the interest on this account and reduce

the principal each year by the sum of £500. The company paid £2,141 10s. pursuant to this arrangement, and Koch as guarantor made payments aggregating £575 in reduction of principal and interest. The arrangement made between the bank and the company in April 1936 was not known to the remainder of the creditors except one, Kemsley & Co. Pty. Ltd., which was the largest creditor after the bank. The company continued to do business with the bank, and on 18th July 1939 the bank made demands on the company and Koch for payment of £7,065 1s. 7d., the company's balance then due to the bank on its two accounts, including the "No. 2 account."

The amount was not paid, and the bank instituted proceedings in the Supreme Court of South Australia against the company and Koch to enforce payment. Among the defences taken (and being the only one relevant to this report) was a contention by the company and Koch that the arrangement made between the parties in 1936 was a fraud on the other creditors and therefore void and released them from any liability to the bank for the advances made by it. Koch also instituted proceedings in the Supreme Court against the bank, relying substantially on the contention set out in his defence in the former action and also the last portion of the letter set out above and claiming a declaration that he was under no liability to the bank under the guarantee mortgage and orders that the bank deliver up the instrument and repay the sum of £575 paid by him to the bank after April 1936 on the company's "No. 2 account." The company also instituted proceedings against the bank, relying substantially on the same contention and claiming similar relief as Koch against the bank. It was ordered that the three actions should be consolidated and heard together. The actions were heard by *Angas Parsons* J., who gave judgment for the bank against Koch and the company for the sum claimed in the first action, declared that Koch was entitled to a declaration that the guarantee mortgage was duly discharged and should be delivered up to him as claimed in the second action and ordered that the third action by the company against the bank be dismissed. He ordered Koch and the company to pay the costs of the bank in the three actions.

Koch and the company appealed to the High Court, and the bank cross-appealed in respect of the declaration made in favour of Koch.

Further facts appear in the judgments hereunder.

Ligertwood K.C. (with him *Culshaw*), for the appellants. In a compromise with creditors any arrangement between a creditor and debtor whereby the creditor gains or seeks to gain preference

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over other creditors is against public policy and is deemed to be fraudulent and void. The effect of such an arrangement is to destroy the debt altogether so that the creditor cannot sue for it, and, if the debt is guaranteed, then the guarantee is also discharged by the fraudulent act. Another consequence is that, if any moneys are paid under such an arrangement by either the debtor or the guarantor, then such moneys can be recovered from the creditor and any securities taken in the course of the fraudulent arrangement must be delivered up and cancelled. The arrangement made between the bank and the company is void on the ground of illegality (*Britten* v. *Hughes* (1); *Mayhew* v. *Boyes* (2)). The analysis of the latter case shows that emphasis is placed on the word "fraudulent." The law is that, if the creditor makes the arrangement behind the backs of other creditors as the bank did in this case, then the transaction is illegal and void (*Ex parte Barrow*; *In re Andrews* (3); *Ex parte Burrell*; *In re Robinson* (4)). That follows irrespective of the intentions of debtor or creditor. There must be full disclosure among all the creditors, and, if one seeks to obtain an advantage over the other creditors, then any transaction giving such an advantage is fraudulent and void. The consequences of such a transaction are that the debt is destroyed by illegality (*Mallalieu* v. *Hodgson* (5); *Ex parte Phillips*; *In re Harvey* (6)), and the bank must deliver up the debenture to the company (*Jackman* v. *Mitchell* (7); *Middleton* v. *Lord Onslow* (8); *Jackson* v. *Lomas* (9); *Fawcett* v. *Gee* (10)). It would not be a security even for the fresh advance. In *American Annotated Cases* (1914), p. 841, a résumé of the law on this point is set out. In *Ex parte Phillips*; *In re Harvey* (6) and *Mayhew* v. *Boyes* (11) the creditor does not lose only the difference between the debt and composition but loses the composition as well, as the consideration is illegal. The bank cannot get the composition. The next consequence is that the company can recover from the bank all moneys subsequently paid by it to the bank. That is an independent cause of action for money paid pursuant to an illegal arrangement (*Smith* v. *Bromley* (12); *Smith* v. *Cuff* (13); *Horton* v. *Riley* (14); *Atkinson* v. *Denby* (15); *In re*

(1) (1829) 5 Bing. 460, at p. 464 [130 E.R. 1139, at p. 1141].
(2) (1910) 103 L.T. 1, at p. 2.
(3) (1881) 18 Ch. D. 464.
(4) (1876) 1 Ch. D. 537.
(5) (1851) 16 Q.B. 689 [117 E.R. 1045].
(6) (1888) 36 W.R. 567.
(7) (1807) 13 Ves. 581 [33 E.R. 412].
(8) (1721) 1 P.Wms. 768 [24 E.R. 605].
(9) (1791) 4 T.R. 166 [100 E.R. 953].
(10) (1797) 3 Anst. 910 [145 E.R. 1079].
(11) (1910) 103 L.T. 1.
(12) (1760) 2 Doug. 696 [99 E.R. 441].
(13) (1817) 6 M. & S. 160 [105 E.R. 1203].
(14) (1843) 11 M. & W. 492 [152 E.R. 899].
(15) (1861) 6 H. & N. 778, at p. 788 [158 E.R. 321, at p. 325]; (1862) 7 H. & N. 934, at p. 936 [158 E.R. 749, at p. 750].

Lenzberg's Policy (1)). The principles are clearly set out in *Atkinson* v. *Denby* (2). In *Wilson* v. *Ray* (3) there was no pressure of the debenture over the debtor's assets, but here there was a threat by the debenture holder to appoint a receiver. In that case the pressure had ceased ; here it had not. In *Spencer Bower* on *Actionable Non-disclosure* (1915), p. 528, *Wilson* v. *Ray* (3) is treated as of doubtful authority. The next question is the effect of Koch's guarantee and his letter. The bank cannot succeed against him, because (*a*) the guarantee is collateral, and, if the principal debt is destroyed, then the guarantee falls with it; the cases show that the debt is destroyed altogether (*McDonald* v. *Dennys Lascelles Ltd.* (4)) ; (*b*) the guarantee was a continuing guarantee and part of its consideration was illegal ; (*c*) the guarantee became an integral part of the illegal transaction and consequently falls with it ; (*d*) under the terms of the guarantee it is to pay the company's indebtedness on demand, and at its date there was no indebtedness. Koch can recover back his documents (*Smith* v. *Bromley* (5) ; *Pendlebury* v. *Walker* (6) ; *Mare* v. *Sandford* (7) ; *Rowlatt* on *Principal and Surety*, 3rd ed. (1936), p. 168 ; *Clay* v. *Ray* (8) ; *Featherston* v. *Hutchinson* (9) ; *Scott* v. *Gillmore* (10) ; *Lound* v. *Grimwade* (11) ; *McKewan* v. *Sanderson* (12)). The effect of the illegal transaction is that the original debt is destroyed (*Ex parte Phillips* ; *In re Harvey* (13) ; *Mayhew* v. *Boyes* (14)). Therefore the surety cannot be called on to pay it. Furthermore, on demand there was no debt due by the debtor (*Smith's Leading Cases*, 13th ed. (1929), vol. 2, p. 412). *Wilson* v. *Ray* (3) is distinguished because in this case payment was not voluntary but was made under a threat by the debenture holder.

Reed K.C. (with him *Moulden*), for the respondent. (*a*) With respect to the arrangement in 1936, it was not a fraud on creditors but was perfectly lawful. (*b*) This arrangement was made subsequently to the composition agreement being entered into and at a time and in circumstances when and in which the bank was entitled to make such an arrangement. It is not disputed that if

(1) (1877) 7 Ch. D. 650.
(2) (1861) 6 H. & N. 778 [158 E.R. 321].
(3) (1839) 10 A. & E. 82 [113 E.R. 32].
(4) (1933) 48 C.L.R. 457, at pp. 479, 480.
(5) (1760) 2 Doug. 696 [99 E.R. 441].
(6) (1841) 4 Y. & C. 424 [160 E.R. 1072].
(7) (1859) 1 Giff. 288, at p. 295 [65 E.R. 923, at p. 926].
(8) (1864) 17 C.B.N.S. 188 [144 E.R. 76].
(9) (1584) Cro. Eliz. 199 [78 E.R. 455].
(10) (1810) 3 Taunt. 226 [128 E.R. 90].
(11) (1888) 39 Ch. D. 605.
(12) (1875) L.R. 20 Eq. 65, at p. 72.
(13) (1888) 36 W.R. 567.
(14) (1910) 103 L.T. 1.

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the arrangement had been contemporaneous with the composition different considerations would have applied. But the essential element that makes an arrangement illegal in such circumstances is that it is made at a time when all creditors are entering into a composition which is based on mutual forbearance. Cases cited are all to the same effect. They show that the secret arrangement was contemporaneous with the composition (*Cockshott* v. *Bennett* (1)). There it is shown that the basis of the rule is a fraud on the creditors at a time when they are considering entering into an arrangement with one another. But it is equally clear that after the composition is completed the debtor can revive the original debt for a good consideration. It is a distinct transaction from the composition, and it does not render the other creditors more remote from getting their money. In fact, in this case, as a result of the transaction they got their money. *Leicester* v. *Rose* (2) lays down the same principle (*Knight* v. *Hunt* (3); *Wood* v. *Barker* (4)).

[STARKE J. referred to *Mahalm* v. *M'Cullagh* (5).]

In those cases the arrangement which was made endangered the assets. A debtor under a composition is left with his assets, and a creditor must do nothing whereby those assets may be diminished and other creditors be left without sufficient assets. If the assets for the payment of the composition are not affected by a genuine subsequent arrangement, then the debtor can for a good consideration agree to pay his debt to any creditor in full. In this case the company could have borrowed the money from anyone, including the bank, to pay off the trustee to enable him to pay the creditors the amount agreed on and the next day agree with the bank to pay its debts in full. The bank was paying the money to complete the composition and in fact did not diminish the company's assets so that other creditors would have less to have recourse to. This agreement being after the composition, it is unimpeachable (*Took* v. *Tuck* (6); *Carey* v. *Barrett* (7); *Wood* v. *Barker* (4); *Wilson* v. *Ray* (8)). *Ex parte Barrow*; *In re Andrews* (9) is distinguishable in that the composition was endangered and the *Bankruptcy Act* 1869 forbade any variations in the composition. In *Ex parte Burrell*; *In re Robinson* (10) the agreement was before the composition, but here the payment was made by the bank to complete the

(1) (1788) 2 T.R. 763 [100 E.R. 411].
(2) (1803) 4 East 372 [102 E.R. 874].
(3) (1829) 5 Bing. 432 [130 E.R. 1127].
(4) (1865) L.R. 1 Eq. 139, at p. 145.
(5) (1891) 27 L.R. Ir. 431, at p. 449; 29 L.R. Ir. 496.
(6) (1827) 4 Bing. 224 [130 E.R. 755]; *sub nom. Tuck* v. *Tooke*, (1829) 9 B. & C. 437 [109 E.R. 163].
(7) (1879) 4 C.P.D. 379, at p. 382.
(8) (1839) 10 A. & E., at p. 86 [113 E.R. at p. 34].
(9) (1881) 18 Ch. D. 464
(10) (1876) 1 Ch. D. 537.

composition. In *Mallalieu* v. *Hodgson* (1) the case depended upon the agreement being contrary to the *Bankruptcy Act*.

Ligertwood K.C., in reply.

Cur. adv. vult.

The following written judgments were delivered :—

RICH A.C.J. I have had the advantage of reading the judgment of my brother *Williams* and agree with it.

STARKE J. Appeal and cross-appeal from a judgment of the Supreme Court of South Australia. The facts of the case are so fully stated in the judgments of *Angas Parsons* J. in the Supreme Court and my brother *Dudley Williams* in this court that I shall confine myself to the questions of law which arise for determination.

In compositions with creditors, the giving up of part of their claim by creditors is a valid consideration for each one giving up a part and accepting a composition in discharge of the whole debt. The essence of a composition arrangement is " that the creditors who take part in the scheme act upon the faith and understanding that they are all coming in upon terms of equality, and if a deed is prepared to carry out this equal distribution, every creditor who executes it does so on the faith that there is no private bargain with any of the other creditors which will destroy this equality " (*Ex parte Milner* ; *In re Milner* (2)). Consequently, any private or underhand dealing in favour of a particular creditor contemporaneously with the composition for the benefit of the general body of creditors is illegal (*Ex parte Barrow* ; *In re Andrews* (3)). A consequence is that the creditor cannot sue for his original debt because his debtor may plead satisfaction or discharge under the composition, and he cannot sue for the composition because the whole agreement with the creditor is infected with illegality (*Mallalieu* v. *Hodgson* (4) ; *In re Myers* ; *Ex parte Myers* (5) ; *Ex parte Phillips* ; *In re Harvey* (6) ; *Mayhew* v. *Boyes* (7)).

The question in this case is whether an agreement or transaction between the respondent bank and the appellant company and to which the other appellant (Koch) assented is illegal. The bank was a creditor of the company, and Koch was a guarantor of the company. The bank was a party to a composition with the company's creditors. After the composition arrangement had been

(1) (1851) 16 Q.B. 689 [117 E.R. 1045].
(2) (1885) 15 Q.B.D. 605, at pp. 615, 616.
(3) (1881) 18 Ch. D., at p. 471.
(4) (1851) 16 Q.B., at p. 711 [117 E.R., at p. 1053].
(5) (1908) 1 K.B. 941.
(6) (1888) 36 W.R. 567.
(7) (1910) 103 L.T. 1.

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entered into, and before it was completed, an agreement was made between the bank and the company, in which the guarantor joined, whereby the bank agreed to advance to the company a sum of money sufficient to enable it to pay the balance of the composition due to the creditors under the composition arrangement and to make further advances to the company in consideration of it accepting liability for the sums advanced and also for all money in which the company would have been indebted to the bank if the composition arrangement had not been made. By this means, the bank would obtain the payment of its debt in full, whilst the other creditors who were parties to the composition arrangement would only obtain the amount agreed upon as a composition in discharge of their debts. Such an arrangement, it was said, destroyed equality amongst the company's creditors, which was the essence of the composition arrangement (*Ex parte Barrow* (1)).

The law, however, does not debar a debtor from paying his just debts if he can, whether he is protected by a release in bankruptcy or not (*In re Bonacina* ; *Le Brasseur* v. *Bonacina* (2)). So, a contract by an undischarged bankrupt, in consideration of a small loan, to pay in full a debt due from him at the commencement of and provable in bankruptcy is not void as contrary to public policy or the *Bankruptcy Acts* (*Jakeman* v. *Cook* (3) ; *Wild* v. *Tucker* (4) ; *Took* v. *Tuck* (5)). A bankrupt, however, gives up his property for the benefit of his creditors, whilst in the case of a composition the debtor is frequently left in command of his assets : a free man entitled to all the rights of ownership and disposition over every part of his property (*Ex parte Burrell* ; *In re Robinson* (6)).

After a composition has been fully and finally worked out, no doubt, I think, can exist that a debtor could lawfully make an agreement for valuable consideration to pay in full the original debt of a particular creditor. The position of the debtor in such a case would be the same as that of a debtor who had obtained his discharge in bankruptcy (*Ex parte Barrow* (7)). Again, moneys, I should think, might in the present case have been borrowed from a stranger and the composition so paid. An agreement then with the bank to make advances to the company and in consideration thereof to pay in full the original debt would be lawful, though the borrowed moneys were repaid from the bank's advances. But still the question

(1) (1881) 18 Ch. D. 464.
(2) (1912) 2 Ch. 394, at p. 401.
(3) (1878) 4 Ex. D. 26.
(4) (1914) 3 K.B. 36.
(5) (1827) 4 Bing. 224 [130 E.R. 755] ; *sub nom. Tuck* v. *Tooke*, (1829) 9 B. & C. 437 [109 E.R. 163].
(6) (1876) 1 Ch. D., at pp. 547, 551.
(7) (1881) 18 Ch. D., at p. 470.

remains whether the agreement made between the company and the bank is inconsistent with good faith to the other creditors, who agreed to accept the composition, and so infected with illegality. *Ex parte Barrow* (1) was relied upon. That case turned upon the facts and the provisions of the *Bankruptcy Act* 1869 governing compositions made pursuant to its terms, particularly sec. 126. It does not expressly decide the question here in contest, but there are some observations in the judgment of Lord *Selborne* (2), in which *Brett* and *Cotton* L.JJ. concurred, which are pertinent to the present case. The facts were :—In April of 1879 Andrews, a debtor, filed a liquidation petition, and the creditors resolved by proper statutory majority to accept a composition of 5s. in the pound in satisfaction of their debts, to be paid by instalments. The resolution was registered. In August of 1879 Barrow, one of the creditors bound by the resolution, entered into an agreement with the debtor, before the first instalment of the composition became due, that his debt should be paid in full and that he should continue to supply the debtor with goods on credit. The pertinent observations of Lord *Selborne* are :—"I must add that there have been many decisions both in courts of law and in courts of equity against the validity of underhand dealings in favour of a particular creditor contemporaneously with a composition for the benefit of the general body of the creditors, and it appears to me that the principles of those decisions are fully and entirely applicable to the present case. But it is said that fresh credit was given by the appellant to the debtor, and that in this way there was a consideration for the agreement to pay the old debt in full. That might well be so in a case like *Jakeman* v. *Cook* (3), where there was no question of good faith with the other creditors, and no question of compliance or non-compliance with the terms of composition resolutions. But no consideration can support an agreement which is inconsistent with good faith to the other creditors, and with the spirit of sec. 126." The judgment recognizes that a private dealing in favour of a particular creditor contemporaneously with a composition for the general body of creditors is inconsistent with good faith, but it goes further. The opinion was also expressed that the private agreement in that case for the benefit of a particular creditor, though not made contemporaneously with the composition agreement, could not stand together with the composition for the benefit of all the creditors for it was inconsistent with good faith. The result of the private agreement might be the sweeping away by the particular creditor

(1) (1881) 18 Ch. D. 464. (2) (1881) 18 Ch. D., at p. 471.
(3) (1878) 4 Ex. D. 26.

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of the whole body of the debtor's assets. *Took* v. *Tuck* (1) is not, I think, opposed to the opinion expressed in *Ex parte Barrow* (2). The allegations made in the pleadings in that case were not inconsistent with good faith: indeed, they were apparently consistent with the debtor having paid the composition and "become a free man." *Best* C.J., however, stated the ground upon which the courts hold that a private agreement for the benefit of a particular creditor contemporaneously with a composition agreement is illegal: "It is the pretending to accept the same terms as the other creditors, and so encouraging them to come into the arrangement, when the party so pretending has at the time secured to himself some advantage, of which the others are not to partake" (3). He does not assert that agreements made subsequently to the composition agreement destroying the equality of creditors, parties to the composition agreement, and inconsistent with good faith, are lawful. He was, I think, dealing with the particular case and making clear that the pleadings did not allege the fraud he mentioned or any other dealing that was necessarily inconsistent with good faith. The nature of the agreement and the circumstances of the case must in the end determine whether any particular agreement is inconsistent with good faith and consequently unlawful.

In my judgment, the arrangement in this case between the bank and the company which has been attacked is not illegal. It is not inconsistent with good faith towards the other creditors of the company. In April of 1936 instalments of the composition which had fallen due had not been paid, though they were secured by a charge. It was in the interest of the company to pay the composition and become free of that obligation and the charge in respect thereof over its assets and to obtain financial assistance for the purpose of carrying on its business. It was equally desirable from the point of view of its creditors that the composition should be paid. The bank undertook to find moneys for the company to discharge the composition and to finance its future operations if the company accepted liability for the further advances and its original debt. It was a business operation beneficial alike to the company, the other creditors, and the bank.

The arrangement, it is said, is inconsistent with good faith because it does not provide for the equal treatment of all the creditors, but that contention fastens upon one feature of the arrangement and ignores the business considerations that dictated it, including the

(1) (1827) 4 Bing. 224 [130 E.R. 755].
(2) (1881) 18 Ch. D. 464.
(3) (1827) 4 Bing., at pp. 228, 229 [130 E.R., at p. 757].

payment of the composition to the creditors. In *Ex parte Barrow* (1) there was no provision for any payment to the other creditors. And, in my opinion, that unhappy branch of the law, public policy, affords no satisfactory basis for invalidating a business arrangement the carrying out of which is beneficial to all who were interested in the company's affairs. Indeed, it is a strong thing for the company and its guarantor to complain of an arrangement in which they joined and reaped the benefits.

The company also sought to avoid its liability by another line of reasoning. It was said that what has been referred to as the composition arrangement of 1934 did not operate as a composition. That arrangement provided that, if certain sums were paid on or before August 1936 and the terms and stipulations of the arrangement observed by the company, then those sums would be accepted and taken by the several creditors in full satisfaction and discharge of the debts of the creditors set forth in the arrangement. The company did not punctually pay all the instalments under the arrangement and did not, I understand, observe all its terms and stipulations. The creditors, however, did not renounce the arrangement, but accepted about May 1936 payment of the balance of the composition then due. The bank, it is said, also stood to the composition in 1936 and in that year arranged with the company to pay the composition and so, contemporaneously with the other creditors, manifested its intention of also accepting the composition arrangement of 1934 without disclosing the new arrangement to the other creditors. This reasoning, however, is but the same contention over again, namely, that the arrangement of 1936 is inconsistent with good faith towards the other creditors. In my opinion, for the reasons already given, that contention ought not to succeed. The company therefore fails in its appeal.

The failure of the company's appeal makes it unnecessary to consider many ingenious arguments raised on behalf of the company's guarantor, the appellant Koch. But one submission requires consideration. In 1934, when the composition arrangement was made, Koch in a letter to the bank informed it that the charge given by the company to the trustee for creditors was not to prejudice or adversely affect in any way the guarantee given by him to the bank, which should "remain in full force and virtue according to the tenor thereof, notwithstanding the fact that there are further operations upon the account at the bank by the company and further moneys lent; and notwithstanding that the bank shares the benefit of the charge upon the property of E. T. Fisher & Co. Ltd. in favour

(1) (1881) 18 Ch. D. 464.

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of Mr. Ferres and in due course may receive satisfaction *pro tanto* and participate in the funds to accrue under the charge." He added: "Provided always that discharge in full by payment under the said charge shall release me from the guarantee." Koch now submits that, upon the proper construction of this letter, he was released from his guarantee upon payment of £7,500, the total amount of the composition. In my opinion, that construction of the letter is erroneous. The debt of the bank was stated in the composition arrangement to be £8,998 15s. 8d., although it actually amounted to £10,656 or thereabouts. The proviso is directed to the fact that the bank may benefit from the future operations of the company and from the charge, so it provides that discharge in full of moneys owing to the bank by payment under the charge shall release the guarantor. But it does not provide that he shall be released upon payment of the total amount of the composition, £7,500.

The judgment below, dated 30th July 1940, should be varied by deleting the declaration numbered 2 and the order numbered 3, and the action No. 843 of 1939 by Koch against the bank should be dismissed.

Accordingly, the appeal of the company and Koch should be dismissed and the cross-appeal of the bank allowed.

McTIERNAN J. I agree that the appeal should be dismissed and the cross-appeal allowed.

The principal question in this case is whether the stipulation in the agreement made in 1936 between the bank and the company for the payment in full of the bank's debt was "in fraud of creditors." Upon the allegation that the stipulation was of this character the appellants found elaborate defences to the bank's action and counter-claims for relief. These need not be gone into unless the supposition upon which they depend be true.

Does this stipulation, which the appellants charge to be in fraud of creditors, assume the character of an underhand bargain giving the bank some advantage over other creditors of the company when it is placed side by side with any composition agreement between the company and its creditors, including the bank? It is impossible to find any ground for attributing to it that character.

The appellants rely upon two arguments to support the allegation of fraud. The first is that the stipulation was made while the composition agreement was still executory and was made without the knowledge of all the creditors. The second is that the composition under which the debts were satisfied and discharged was made

in 1936 when the creditors received the balance of the composition which they had agreed to accept under the composition arrangement made in 1934 and that in relation to the supposed composition in 1936 the stipulation for payment in full of the bank's debt gave the bank an advantage over other creditors in the composition which was concealed from them.

As regards the first argument, the executory state of the composition at the time the impugned stipulation was made has not in itself any bearing on the question whether the stipulation was in fraud of the creditors. The decisive consideration is that the composition had already been made, and it was not made in pursuance of any such understanding as would falsify the representation which the bank made by becoming a party to the composition agreement. Thereby it represented that it, like the other creditors, was consenting to forgo so much of its demand upon the company as appears from the terms of the agreement. That representation was quite true. Indeed, it is quite clear from the case that the stipulation was not contemplated when the composition arrangement of 1934 was signed.

The second argument seeks to fix a composition at such a time that it would clearly have been in fraud of the creditors for the bank to have procured or retained an arrangement for the payment of its debt in full. The foundation of this argument is that, as the conditions of the composition agreement of 1934 had not been fulfilled and the creditors had, therefore, become entitled *inter se* to demand payment in full, a new composition was in fact made when each creditor accepted in full satisfaction and discharge payment of the composition stipulated in the previous composition agreement. The argument assumes that there was a consensus among the creditors to make a new composition in place of the previous one. The facts are not susceptible of that inference. In my opinion, they leave room for no other inference than that each creditor accepted the payment of the balance of the composition stipulated in the composition agreement of 1934 as a performance of that agreement. In my opinion, this argument also fails.

It follows that, in so far as the defences of the appellants and their claims for relief depend upon the charge that the bank made an agreement in fraud of creditors, these defences and claims fail. The company's defences and claims for relief depend exclusively on this allegation of fraud.

The defence and claim that the surety bases on the letter of 11th July 1934 also fail because the letter upon its true construction

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does not manifest an intention on the part of the bank to release the surety from his liability to pay the full amount of the company's debt to the bank within the limit of the guarantee.

WILLIAMS J. This is an appeal and cross-appeal against a judgment of the Supreme Court of South Australia given on 30th July 1940, in three actions which were ordered to be consolidated. The interested parties in the actions were the English Scottish and Australian Bank Ltd., E. T. Fisher & Co. Pty. Ltd., and John Ludwig Koch. Briefly stated, the bank sought judgment against the company and Koch for the sum of £7,048 3s. 6d., the balance alleged to be due by the company of the amount allowed on overdraft on the current account of the company with the bank on 30th June 1939, and interest at five per cent per annum from that date until payment; while the company and Koch denied they were indebted to the bank at all and sought to recover certain payments made by them to the bank and claimed to be entitled to have certain documents executed by them respectively in favour of the bank delivered up discharged by the bank. The company was incorporated in 1928. It became a customer of the bank, which granted it from time to time substantial advances by way of overdraft. The shareholders of the company were Koch, who held 24,476 shares, Lower, who held 751 shares, and three other shareholders, who held one share each. Koch and Lower were directors of the company; Lower was also the manager of the company. On 17th December 1929, in order to secure the company's overdraft, Koch gave the bank a guarantee mortgage containing a personal covenant over the land on which the company was carrying on its business, which belonged to him, and over a house in a suburb in Adelaide which he owned. The mortgage provided that the acceptance of any composition by the bank should not in any wise discharge Koch from any liability therein contained nor otherwise affect or prejudice the security. This mortgage was stamped to cover advances up to £6,000. The company's business expanded, and its overdraft exceeded £6,000. On 1st August 1930 Koch gave the bank a further guarantee to secure advances to the company up to £10,500. This guarantee contained a similar clause to the guarantee mortgage with respect to compositions.

Towards the end of 1930 the company got into financial difficulties and from then on until 3rd August 1934 was unable to pay its debts. A meeting of creditors was held on 16th December 1931, when it was resolved that the business should be carried on under the supervision of L. W. Ferres. Various plans were suggested to enable the

company to carry on its business and pay its debts, and eventually the creditors assented to a composition scheme which is embodied in the indenture of charge dated 3rd August 1934. Ferres' management of the company had not been a success ; he had only succeeded in paying the creditors 1s. in the £1, and on 18th April 1934 Koch and Lower had resumed the management of the company so that at the date of the indenture of charge they were in charge of the affairs of the company. The provisions of the indenture of charge were assented to by all the creditors of the company. The indenture contained a recital of the company's debts, which were shown at a total of £11,951 7s. 10d. The debts were itemized and were stated at the original amounts shown to the meeting of creditors held on 16th December 1931, less the dividend of 1s. in the £1, so that no creditor was allowed any interest after 31st May 1931. The sum of £11,951 7s. 10d. was described as the sum "hereby secured." There was a covenant that the company would pay the sum thereby secured at the times, in the instalments and in the manner set forth in the conditions annexed to the indenture. Then followed a proviso that "if the company shall pay to the trustee the sum of seven thousand five hundred pounds (£7,500) (together with the sum of four hundred and fifty pounds (£450) heretofore advanced to the company by the trustee out of the trust account hereinafter mentioned and any further sum so advanced) on or before the 18th day of August, 1936, and shall duly and punctually observe and perform all the covenants conditions agreements and stipulations herein contained and on the part of the company to be observed performed and kept the said sum of seven thousand five hundred pounds (£7,500) (and such further sums) shall and will be accepted and taken by the said several creditors or by the trustee on their behalf in full satisfaction and discharge of the sum hereby secured." The creditors had therefore agreed that, subject to fulfilment by the company of the conditions specified, they would accept a sum of £7,500, or, in other words, 12s. 6d. in the £1, in full payment of their debts.

During the negotiations which resulted in the execution of the indenture of charge Koch had signed and delivered to the bank on 11th July 1934 a letter in the following terms :—"The debts due to its creditors by E. T. Fisher & Co. Ltd., including the E. S. & A. Bank Ltd., will be secured as you know by the charge to be executed by that company in favour of Mr. L. W. Ferres as trustee for the said creditors. I have already guaranteed payment by the company to the E. S. & A. Bank. This letter is to inform you that the charge about to be given by the company to Mr. Ferres will not prejudice

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or adversely affect in any way the guarantee given by me to the bank as mentioned above. This guarantee will remain in full force and virtue according to the tenor thereof notwithstanding the fact that there are further operations upon the account at the bank by the company and further moneys lent and notwithstanding that the bank shares the benefit of the charge upon the property of E. T. Fisher & Co. Ltd. in favour of Mr. Ferres and in due course may receive satisfaction *pro tanto* and participate in the funds to accrue under the charge. Provided always that discharge in full by payment under the said charge shall release me from the guarantee." After the execution of the indenture of charge the company continued to carry on its business under the management of Lower and from time to time made payments of the instalments to Ferres as trustee for the creditors. But in 1935 it fell into arrears and thereafter remained in arrears with the instalments. In March 1936 the arrears were £575. On 24th March 1936 Robertson, the branch manager of the bank in Adelaide, wrote a letter for the information of the joint general managers of the bank in Melbourne. Its effect was that the bank should provide the company immediately with a sum of £1,833 to pay to Ferres. This with the moneys already paid by the company to Ferris would make up £7,500. Ferres was to give a full discharge on behalf of the creditors. As a condition of making the advance, the bank was to obtain from the company a debenture to cover, not only the £1,833, but the whole balance of the company's overdraft with full compound interest charged from December 1931. In other words, while the other creditors were to get a composition the bank was to get its debt in full. The joint general managers gave their approval to this scheme on 2nd April 1936. Robertson approached Lower and got his approval to the scheme, and correspondence then took place between Robertson, Lower and Koch, during the course of which Koch also approved. A new debenture was prepared by the bank's solicitors and was executed by the company on 27th April 1936. This debenture gave the bank an equitable charge over the whole of the company's assets to secure all moneys in or for which the company was then or should for the time being be indebted or liable to the bank. It provided that it should not affect any guarantee held by the bank as security for the debt, and that it should be a collateral security with the guarantee mortgage.

On 28th April 1936 the amount required to make up the £7,500 was £1,825 10s. On that day the bank permitted Lower to draw a cheque on the bank on the company's behalf for £1,825 10s. and Lower sent cheques to Ferres to pay the balance of the £7,500. On

29th April 1936 Ferres gave a receipt for the £1,825 10s., being the balance due under the indenture of charge. On 8th May 1936 Ferres distributed the moneys among the creditors (including the bank) by cheques enclosed in circular letters showing that the payments were the final dividend required to make up the £7,500. On the distribution the bank got back £1,373 15s. 2d. out of £1,825 10s. A full discharge of the indenture of charge was then prepared and executed by Ferres on 14th May 1936. Ever since 1st December 1931 the company's overdraft account with the bank had been a liquidation account. Substantially the only debits to it were for interest, and the only credits were the dividends received from Ferres. The interest debited to May 1936 amounted to £2,317 12s. 3d. On 11th May 1936 the bank closed the company's old account by transferring the debit balance therein, amounting to £7,691 6s. 10d., to a new account called "No. 2 account." During the negotiations for the new debenture it was agreed between Robertson, Lower and Koch that the company should thereafter keep down interest on the overdraft and in addition pay £500 a year off the principal. Pursuant to this arrangement the company, subsequent to the opening of the No. 2 account, made payments to the bank in respect to the overdraft aggregating £2,141 10s. About 18th May 1936 Koch, who was living in Melbourne, visited Adelaide, and Robertson then pressed him for further payments and obtained a letter from him (prepared by Robertson) stating that he would make weekly payments of £10 until £1,000 was paid. Following this letter Koch made payments to the bank aggregating £575. These are the two amounts which the appellants seek to recover from the bank. The creditors, other than the second largest creditor, Kemsley & Co. Pty. Ltd., were not informed and had no knowledge of the company's having agreed to pay the bank's debt in full.

On 18th July 1939 the bank made demands upon the company and Koch for the payment of the balance due to the bank on the company's overdraft, which was then stated to be £7,065 1s. 7d. The amount was not paid, and the three actions already mentioned were commenced.

The company and Koch allege that the bank is not entitled to recover its debt or any part thereof because of its action in 1936 in arranging to advance the sum of £1,825 10s. to the company to enable it to pay Ferres the balance of £7,500 in consideration of the company agreeing to pay the bank the full amount of its debt for principal and interest instead of the dividend of 12s. 6d. in the £1 on the sum of £8,998 15s. 8d. provided for by the indenture of charge. On behalf of Koch it is also contended that his liability on

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the two guarantees was determined when the bank was paid this dividend. There does not appear to be any substance in the second contention, which is based on the construction of the proviso to the letter of 11th July 1934. This proviso must be construed in the light of the whole context of the document; if it is ambiguous, it is permissible to have regard to the subsequent acts of the parties to ascertain the meaning which they themselves attributed to it (*Watcham* v. *East Africa Protectorate* (1)). The evidence shows that the parties subsequently acted consistently on the basis that Koch remained liable under his guarantees for the full amount of the bank's debt. The proviso appears to me to refer either to payment of the full amount of the bank's debt for principal and interest or to payment in full of the bank's debt mentioned in the recitals to the indenture of charge, viz., £8,998 15s. 8d. I do not think it can mean, as suggested by the learned trial judge, payment of the composition of 12s. 6d. in the £1. Such a construction does not give effect to the earlier part of the document which refers to the whole debt or to the words " in full " or " payment." I am strongly inclined to think that the true meaning is payment to the bank of the whole debt, because the proviso contemplated the bank making further advances to the company, and these would not be included in the sum of £8,998 15s. 8d., but it is unnecessary to decide between the two alternative constructions, because the company never paid the bank either sum, so that on either construction the proviso never operated. If it had done so, it would have caused a release of both guarantees, as it is difficult to believe the parties could have intended Koch to be released from the guarantee of 1930 and still remain liable on that of 1929. The proviso really refers in a compendious way to Koch's liability under the guarantees and not to one or other of the documents themselves.

The agreement for the composition made in August 1934 was one in which no creditor obtained any advantage over the others. There could be no objection to the bank having the additional rights in respect of the balance of its debt against Koch under the guarantees. The original debt of the company to the bank had been discharged by the new agreement contained in the indenture of charge, but this original debt remained in force between the bank and Koch because the guarantees had each provided that the rights of the bank against the guarantor should not be affected by the bank making such a composition. If, therefore, no further agreement had been made between the company and the bank subsequently to the indenture of charge, there would have been nothing to prevent the

(1) (1919) A.C. 533.

bank from receiving its composition of 12s 6d. in the £1 from the trustee for the creditors and recovering the balance of its whole debt from Koch.

It is necessary to consider what effect the events which occurred in 1936 had on these rights. Mr. *Ligertwood*, for the appellants, the company and Koch, has contended that in a composition with creditors any arrangement made with the debtor by one creditor by which he gains or seeks to gain a preference over other creditors is against public policy and is fraudulent and void; that the effect of such an arrangement is to destroy the debt so that the creditor cannot sue for it; that when any such debt is guaranteed the guarantee is discharged by the fraudulent agreement; that any moneys paid under such arrangement whether by the debtor or by the guarantor can be recovered from the creditor; and that securities taken in the course of the fraudulent arrangement must be delivered up to be cancelled. Summarized, his contention is that the contract made between the bank and the company in 1936 was in breach of the agreement made between the creditors in 1934 to discharge their debts on receipt of a composition of 12s. 6d. in the £1 and was a secret benefit to the bank at the expense of the other creditors which vitiated and destroyed the rights of the bank to recover any moneys from the company or Koch under the guarantees or to recover the sum of £1,825 10s. advanced by the bank to the company to pay the final dividend on the composition from the company and entitled the company and Koch to recover from the bank the amounts of £2,141 10s. and £575 already mentioned and to have the debenture and guarantees delivered up discharged by the bank.

It is clear that the contract by which the creditors mutually agree to forbear to sue for the full amount of their debts and to accept a composition is a contract *uberrimae fidei*, and that, if any creditor makes a secret stipulation with the debtor for some additional benefit for himself, as, for instance, the payment of the balance of his debt, contemporaneously with the contract for the composition, the law considers such a stipulation to be fraudulent and opposed to public policy and therefore void, and not only will not allow him to recover or retain any such secret benefit but also regards it as vitiating and destroying his rights to recover his share of the composition. At the same time the law considers the original debt to have been discharged by the composition, and the result is that the creditor cannot recover either the original or the compounded debt (*Mallalieu* v. *Hodgson* (1); *Mayhew* v. *Boyes* (2); *Leake* on *Contracts*, 8th ed. (1931), p. 595). None of the authorities, however, suggests

(1) (1851) 16 Q.B. 689 [117 E.R. 1045]. (2) (1910) 103 L.T. 1.

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that the original debt becomes tainted, as Mr. *Ligertwood* contended, by the creditor's fraudulent conduct, and I do not see how any such tainting could occur.

In the present case the debt of the company to the bank existing in August 1934 had been lawfully incurred for advances made by the bank to the company from time to time, and the bank could have sued the company to recover this debt if it had not been discharged by the composition. This debt was guaranteed by Koch, and his liability by express agreement with the bank was not released by the composition (*Perry* v. *National Provincial Bank of England* (1)), so that any fraudulent conduct of the bank in relation thereto would not invalidate its rights against Koch.

The agreement between the company and the bank in 1936 was not contemporaneous with the composition deed. It was made two years subsequently thereto and was an entirely distinct and separate agreement. It was entered into while payments had still to be made under the indenture of charge, so that the composition was still executory, but it did not hinder the creditors being paid. In fact it facilitated payment because the bank provided the necessary moneys to pay the final dividend. A creditor who enters into a composition acts properly so long as he makes full disclosure at the time to all the other creditors of any agreements he may have with the debtor for a preference. After the deed has been executed the debtor is freed from the balance of the debts beyond the dividends he has agreed to pay. Each creditor has forborne to sue for the balance of his debt in consideration of the other creditors forbearing to sue for the balance of their debts, and the debtor has been released from the original debts and therefore from all these balances. The debtor is left the master of his assets so far as they are not charged or otherwise dealt with by the composition. It is to his interest to pay the creditors the amount of the composition and discharge his obligations to them. It is to their interest to be paid. To raise the necessary funds to pay the creditors the debtor can make any new bargain he likes, and if he makes a bargain with one of the creditors he can agree to pay the balance of that creditor's old debt. The creditor who executes a composition deed only agrees to forbear to sue for the balance of his debt under a then existing right. He does not agree not to acquire a new right to recover the balance for some new consideration such as a further advance. In *Ex parte Barrow*; *In re Andrews* (2) Lord *Selborne* pointed out that there have been many decisions against the validity of underhand dealings

(1) (1910) 1 Ch. 464.

(2) (1881) 18 Ch. D., at p 471.

in favour of particular creditors *contemporaneous* with a composition by the general body of the creditors. In *Took* v. *Tuck* (1) the decision was based to a great extent on the form of the plea. The judgments, however, contain several statements to the effect that a bargaining by a creditor with the debtor for the payment of his full debt subsequent to the execution of the composition agreement is not fraudulent. *Best* C.J. said: "It is the pretending to accept the same terms as the other creditors, and so encouraging them to come into the arrangement, when the party so pretending has *at the time* secured to himself some advantage, of which the others are not to partake, which constitutes the fraud on the other creditors" (2). *Littledale* J. said: "I agree that the day alleged as the time when the bond was given is not material, but we must take it to have been given after the agreement for the composition; *and unless it was part of the same agreement it was not a fraud*" (3). This case was referred to by *Isaacs* J. in *Howden* v. *Cock* (4). In *Carey* v. *Barrett* (5) Lord *Coleridge* said: "I believe that the general understanding of the profession has been that a payment in excess made afterwards will not avoid the composition, unless made in pursuance of a previous understanding." In *In re Lenzberg's Policy* (6) *Hall* V.C. said: "It is therefore not clear that the giving of the memorandum was a distinct transaction." It is established that a promise given upon a new consideration to repay the balance of the old debt is valid if made when the composition agreement has been fully executed by payment and the discharge of the debtor: See *Knight* v. *Hunt* (7); *Wild* v. *Tucker* (8). There does not appear to be any distinction in principle between an agreement by the debtor with one of his creditors to pay the balance made after payment of the composition and such an agreement made subject to payment thereof. If the agreement was to pay such balance in priority to or in competition with the composition, then the creditors would be prejudiced because the debtor would be employing assets for his purpose which would otherwise be available for the creditors generally, and such an agreement might be unlawful. But, once the composition has been paid or payment has been provided for, it is immaterial to the creditors how the debtor disposes of his assets. He is then free.

(1) (1827) 4 Bing. 224 [130 E.R. 755]; and, on appeal, *sub nom.* *Tuck* v. *Tooke*, (1829) 9 B. & C. 437 [109 E.R. 163].
(2) (1827) 4 Bing., at pp. 228, 229 [130 E.R., at p. 757].
(3) (1829) 9 B. & C., at p. 445 [109 E.R., at p. 166].
(4) (1915) 20 C.L.R. 201, at p. 223.
(5) (1879) 4 C.P.D. 379, at p. 382.
(6) (1877) 7 Ch. D. 650, at p. 654.
(7) (1829) 5 Bing. 432 [130 E.R. 1127].
(8) (1914) 3 K.B. 36.

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In the present case the bank could have advanced the £1,825 10s. to pay the composition and immediately after it was paid have agreed with the company for the payment of the balance of the old debt. Such an agreement would have been valid, and there does not appear to be any distinction in principle between such an agreement and the agreement in the present case whereby the bank provided the sum necessary to complete the composition and the company agreed that subject to such completion the bank was to have a security over the company's assets for the balance of the old debt, the advance of £1,825 10s. and any further advances made at its pleasure.

Mr. *Ligertwood* contended that, although the agreement for a compromise was entered into in August 1934, it was conditional upon the instalments being punctually paid, so that the compromise only took place in May 1936, when the creditors accepted the final dividend and thereby waived their rights to recover the full amount of their recited debts. He said, therefore, that the secret benefit obtained by the bank was contemporaneous with the agreement for the compromise and fraudulent and void because the creditors, in deciding whether or not to accept the final dividend in full discharge of their debts, ought to have been told that the bank was to receive its full debt. The material date, however, to determine whether the bank had stipulated to receive a secret benefit or not must be August 1934. That was when the creditors agreed to accept the 12s. 6d. in the £1 subject to the performance of conditions which they could waive, the most material condition being that the money should be paid on or before 18th August 1936. The final dividend was paid on the basis that it was to be accepted as the completion of this composition. The circular letter of 8th May 1936 makes this clear. The only agreement between the creditors for a composition was that made in August 1934. The subsequent payments were made in purported performance of that agreement. The 1936 agreement was not contemporaneous therewith. It was a subsequent, separate and independent agreement altogether; the validity of such an agreement could not depend upon whether the instalments were or were not in arrears at the time it was made. If it is correct that the composition provisions of the indenture of charge had been extinguished by the failure of the company to pay the instalments regularly, then there was no agreement for a composition in 1936, and each creditor was entitled to the full amount of his recited debt and free to make any bargain he liked with the debtor which was not a breach of the provisions of the indenture of charge still in force, without reference to the other creditors.

In my opinion, therefore, the bank was entitled to enter into the agreement of 1936; even if it was not, the appellants would not be greatly advantaged, because the only agreement that would become fraudulent and unenforceable would be the agreement of 1936. Fraud in relation to the agreement of 1936 could not affect the validity of the composition agreement or the obligation of the surety to pay the whole debt. The £1,825 10s. the bank paid to the company would not be recoverable by action (*In re Myers*; *Ex parte Myers* (1)); but equity would only order the debenture to be discharged upon the company doing equity and repaying the amount of this and any subsequent new advances less the sum of £2,141 10s. (*Langman* v. *Handover* (2)). The bank could not recover the difference between the amount of the composition and the full amount of this old debt from the company but would still be able to recover this amount from Koch.

For these reasons I am of opinion that the appeal should be dismissed, but the cross-appeal should be allowed.

Appeal dismissed with costs. Cross-appeal allowed with costs. Judgment and order of Angas Parsons J. varied by discharging so much of it as declared and ordered that the guarantee dated 1st August 1930 and referred to in the writ of summons in the action in the said Supreme Court No. 651 of 1939 had been duly discharged and that it be delivered up to the said John Ludwig Koch. Order that the action in the said Supreme Court No. 843 of 1939 by John Ludwig Koch against English Scottish and Australian Bank Ltd. be dismissed.

Solicitor for the appellants, *G. V. Culshaw*, Adelaide, by *Bullen & Burt.*

Solicitors for the respondent, *Moulden & Sons*, Adelaide, by *Trevor Morris.*

O. J. G.

(1) (1908) 1 K.B. 941.

(2) (1929) 43 C.L.R. 334.