HIGH COURT OF AUSTRALIA

Dolores Lavin & Anor

Vs.

Paola Toppi & Ors

[2015] HCA 4

(French CJ., Kiefel, Bell, Gageler and Keane JJ.)

11.02.2015

ORDER

French Cj, Kiefel, Bell, Gageler and Keane JJ.

1. The question in this appeal is whether a surety who pays a creditor a disproportionate amount of a guaranteed debt is entitled to recover contribution from a co-surety when the creditor has given that co-surety a covenant not to sue for The Court of Appeal of the Supreme Court of New South Wales answered this question in the affirmative, holding that the creditor's covenant not to sue the co-surety did not release the co-surety from liability under the guarantee. As a result, all co-sureties continued to share coordinate liabilities under the guarantee, so that the sureties who paid more than their proportionate share of the guaranteed debt were entitled to recover contribution from their co-surety. As will appear from the reasons which follow, the Court of Appeal was correct. In addition, the Court of Appeal's conclusion is supported by a broader equitable view of the rights of co-sureties between each other.

Background

2. The first appellant ("Ms Lavin") and the first respondent ("Ms Toppi") were directors of, and equal shareholders in, a company, Luxe Studios Pty Ltd ("Luxe"). In 2005, Luxe purchased a property in Liverpool Street, Sydney ("the Liverpool Street property") for the purpose of conducting a photographic studio business. The purchase was funded by a loan of $4.29 million from the National Australia Bank ("the Bank"). Further loans were made by the Bank in 2007 and 2008. In October 2008, the various loans were consolidated into one loan to Luxe in the amount of $7,768,000 ("the loan").

3. The loan was guaranteed jointly and severally by Ms Lavin, the second appellant (a company associated with Ms Lavin), Ms Toppi, the second respondent

(Ms Toppi's husband), and Luxe Productions Pty Ltd (a company jointly owned and controlled by Ms Lavin and Ms Toppi) ("the guarantors").

4. The provisions of the guarantee were addressed to the guarantors. Clause 6.2 provided relevantly:

   "*You* guarantee that the *customer* [ie Luxe] will pay *NAB* all the *amounts which the customer owes NAB* at any time. If the *customer* does not pay an amount when due, *you* agree to pay that amount to *NAB* when *NAB* demands it." (emphasis in original)

Clause 14 of the guarantee was relevantly as follows:

"**What will <u>NOT</u> end *your* liability**

...

14.2 *Your* obligations under this Guarantee are not *affect*ed by anything that might otherwise *affect* them under the law relating to sureties, *including*:

(a) any change in the legal capacity, rights or obligations of the *customer*, a co-guarantor, any other *person* or *you*; or

...

(c) the fact that, in relation to any *amounts which the customer owes NAB* or any *security* (whether given by the *customer*, *you* or a co-guarantor), guarantee or indemnity for them, *NAB*:

(i) obtains a judgement against the *customer*, a co-guarantor or any other *person*; or

(ii) gives up, releases, varies or exchanges, or fails to obtain, perfect, register or realise, or deals in any other way with the *security*, guarantee or indemnity; or

(iii) grants time or any other concession to, or compounds or compromises with, or does or omits to do anything which *affects* the obligations of, the *customer*, a co-guarantor or any other *person* to *NAB* or to *you*; or

...

(i) the fact that any *amounts which the customer owes NAB* may not be recoverable from the *customer*, a co-guarantor or any other *person* for any reason". (emphasis in original)

Clause 16 of the guarantee provided, relevantly:

> "***You* give up certain rights**
>
> 16.1 *You* waive any rights which *you* have as surety at any time which may be inconsistent with the provisions of this Guarantee or which would restrict *NAB*'s rights or remedies under it." (emphasis in original
> Clause 20 of the guarantee provided:
>
> "***Your* liability is separate to all other security *NAB* holds**
>
> 20. Despite any rule of law or equity to the contrary:
>
> (a) this Guarantee is additional to every other *security*, guarantee, indemnity, right and remedy *NAB* holds (*including* from *you*) now or later; and
>
> (b) this Guarantee and *NAB*'s rights and remedies under it and any other *security*, guarantee, indemnity, right, remedy or instrument which *NAB* has at any time continue to exist separately and do not merge with or *affect* each other." (emphasis in original)

On 11 November 2009, Luxe went into receivership. On 3 March 2010, the Bank made demands upon each of the guarantors for payment of the balance of the loan. When those demands were not met, the Bank commenced proceedings against all of the guarantors to enforce the guarantee.

1. On 11 May 2010, the Liverpool Street property was sold. The proceeds of sale were paid to the Bank, but Luxe remained indebted to the Bank for over $4 million.

2. On 21 July 2010, the appellants – but not the respondents – filed a cross-claim against the Bank seeking a declaration that the guarantee was unenforceable because it had been procured in circumstances that were unconscionable within the meaning of the *Trade Practices Act* 1974 (Cth) or unjust within the meaning of the *Contracts Review Act* 1980 (NSW).

3. On 8 September 2010, the appellants and the Bank entered into a deed of release and settlement in relation to the proceedings between them ("the deed"). By cl 3 of the deed, Ms Lavin agreed to pay the Bank $1.35 million in respect of the guaranteed debt and approximately $1.73 million in respect of other personal loans ("the settlement sum").

4. By cl 8(a) of the deed, the appellants agreed to release the Bank from all claims in respect of the guarantee; and, by cl 8(b) of the deed, the Bank covenanted not to sue the appellants in respect of the guarantee, provided Ms Lavin paid the settlement sum.

5. Clause 8(b) of the deed provided for the filing of two consent judgments upon the settlement sum being paid: one judgment dismissing the Bank's claim against the appellants, the other dismissing the appellants' cross-claim against the Bank. Clause 8(c) of the deed provided, relevantly:

> "Noting [scil, Nothing] in this deed, compromises, prejudices or affects NAB's rights against Neil Cunningham [the second respondent], Paola Toppi, Luxe Productions Pty Ltd ... and/or Luxe ... whatsoever, including without limitation in respect of the Guarantee".

6. The settlement sum was eventually paid to the Bank and the proceedings between the Bank and the appellants were dismissed by consent.

7. In early 2011, Ms Toppi and her husband sold their home and used the proceeds of sale to pay the balance of the guaranteed debt, which was then approximately $2.9 million. Upon payment of that amount, the guarantors' obligations to the Bank under the guarantee were discharged.The proceedings

<u>The respondents commenced proceedings in the Equity Division of the Supreme Court of New South Wales claiming, inter alia, contribution from the appellants in the amount of $773,661.04, being an amount equal to half the difference between the respective amounts paid by the appellants and the respondents in discharging the guarantee. The appellants resisted the respondents' claim on the basis that the appellants and the respondents were not under "co-ordinate liabilities", ie liabilities "of the same nature and to the same extent", because, by reason of the Bank's covenant not to sue, the respondents' liability under the guarantee remained enforceable while the appellants' liability was not.</u>

<u>Decision of the primary judge</u>

The primary judge (Rein J) considered himself bound to reject the appellants' submission by reason of the decision of the Court of Appeal of the Supreme Court of New South Wales in *Carr v Thomas*, which held that a creditor's covenant not to sue a particular co-surety had no effect on the rights of contribution of the co-sureties among themselves. His Honour observed that, apart from being authority binding upon him, *Carr v Thomas* had the "considerable attraction ... of precluding one surety, with the assistance of the creditor, from being able to saddle other sureties with a disproportionate amount of liability."

1. His Honour ordered the appellants to pay contribution for the amount claimed (minus a small deduction on account of interest, which is no longer of any moment).

Decision of the Court of Appeal'

1. In the Court of Appeal, the appellants argued that *Carr v Thomas* was unsupported by authority and clearly wrong in principle. Leeming JA (with whom Macfarlan and Emmett JJA agreed) rejected that argument.

1. Leeming JA concluded that, while the precise question decided by *Carr v Thomas* had not arisen in any earlier case, the decision in that case was correct as a matter of principle. His Honour said:

> "In point of principle, a covenant not to sue (in the usual form) does not alter an existing liability. Giving such a covenant means merely that the covenantor is in breach if it does sue."

2. Leeming JA proceeded on the basis that the Bank's covenant not to sue was premised on the continuing liability of the covenantees. Because the covenant did not extinguish the appellants' liability under the guarantee, it followed that the appellants and the respondents continued to share liabilities of the same nature and extent so as to entitle the respondents to recover contribution from the appellants.

3. Leeming JA also rejected the appellants' contention that they received no benefit from the respondents' discharge of the balance of their liability to the Bank. His Honour held that, since the appellants remained liable under the guarantee notwithstanding the Bank's covenant not to sue, the appellants benefitted from the respondents' payment of $2.9 million. In this regard, his Honour said:

> "Prior to the payment, [the appellants were] liable to pay [their] share of the guaranteed debt, albeit that the bank had promised not to enforce it. After the payment, there was no guaranteed debt left to pay."

The appeal to this Court

4. On 12 September 2014, French CJ and Gageler J granted the appellants special leave to appeal to this Court.

5. In this Court, the appellants submitted that the Court of Appeal erred in holding that the respondents and appellants shared coordinate liabilities of the same nature and extent at the time the respondents paid the guaranteed debt. The appellants argued that their liability was "qualitatively different" from the respondents' liability in that the respondents' liability was enforceable by the Bank while the appell nts' liability was not. The appellants also argued that the Court of Appeal erred in holding that the appellants benefitted from the respondents' discharge of the guarantee. It was said that the discharge of the guarantee conferred no real or

practical benefit on the appellants because, by the time the respondents discharged the guarantee, no liability under the guarantee could be enforced against the appellants. This lack of practical benefit was said to be fatal to the respondents' claim because the purpose of the doctrine of contribution is the prevention of unjust enrichment by one co-surety at the expense of another. The appellants' argument seized upon the timing of the covenant not to sue. It was said that the respondents' right to contribution depended on the respondents and appellants sharing coordinate liabilities at the date of the respondents' payment of the balance of the guaranteed debt. It was said that only at that time could a right to seek contribution accrue to the respondents; yet at that time the appellants and respondents no longer shared coordinate liabilities because the appellants could no longer be sued by the Bank. There are two answers to the appellants' argument. The first is that given by the Court of Appeal, ie that the Bank's covenant not to sue the appellants did not extinguish, but indeed assumed, the appellants' ongoing liability for the guaranteed debt. Accordingly, the appellants and respondents shared coordinate liabilities to the Bank under the guarantee both before and after the covenant not to sue. The second answer is that the respondents' right to contribution from the appellants was cognisable in equity even before the respondents made their disproportionate payment to the Bank and could not be defeated by the separate agreement of the Bank and the appellants. Before elaborating upon these points, the juridical foundation of the right to contribution should be noted.

Foundation of the right to contribution

The rationale of the right to contribution, both at law and in equity, was described by Kitto J in *Albion Insurance Co Ltd v Government Insurance Office (NSW)* "as one of natural justice" which ensures "that persons who are under co-ordinate liabilities to make good the one loss (eg sureties liable to make good a failure to pay the one debt) must share the burden pro rata." In cases of suretyship, the concern is to ensure that the common burden of suretyship is borne equally as between co-sureties, so that the exercise by a creditor of its contractual right under its guarantee to recover the guaranteed debt in full from one of several co-sureties does not leave that surety to bear a disproportionate share of the burden of suretyship.

1 The appellants and respondents each agreed to pay the full amount of the guaranteed debt. Each of them became liable to pay that debt upon demand by the Bank under cl 6.2 of the guarantee.

2 In *Mahoney v McManus*, Gibbs CJ (with whom Murphy and Aickin JJ agreed) said that:

"the doctrine of contribution is based on the principle of natural justice that if several persons have a common obligation they should as between themselves contribute proportionately in satisfaction of that obligation. The operation of such a principle should not be defeated by too technical an approach".

3. The appellants' argument is both novel and unduly technical. Only upon such an approach could there be any question at all as to the existence of the common obligation necessary to found the respondents' right to contribution.

Coordinate liabilities

4. From the moment of Luxe's default, or at the very latest from the Bank's demand on the guarantors, each of the guarantors was under a common obligation to pay to the Bank the whole of the guaranteed debt. As persons jointly or severally liable in respect of the same debt, each of them was bound, among themselves, to contribute equally to the discharge of that liability. At that time, each of them shared "a common interest, and a common bur[d]en" in respect of the guaranteed debt. Leeming JA was correct to hold that the Bank's covenant not to sue the appellants did not discharge their liability under the guarantee. The significance, in the law of suretyship, of a covenant not to sue is that the covenant does not operate as a discharge of the guaranteed liability. The utility of the device of the covenant not to sue is that it does not discharge the liability of the covenantee under the guarantee, and so avoids the discharge of the liability of one surety operating to release all co-sureties. That utility is not negated by the ability of the creditor and co-sureties to contract for the preservation of liability in the event of discharge, as the appellants argue was achieved by cl 14.2 of the guarantee. The covenant not to sue removes the need for the creditor to rely on such contractual preservation of liability. It should be noted here that counsel for the appellants disavowed any suggestion that the Bank's covenant not to sue effected a discharge of the appellants' liability under the guarantee.The appellants' counsel insisted that the covenant not to sue effected a qualitative alteration in the appellants' liability under the guarantee which was such as to preclude a claim for contribution by a co-surety. That contention has no support in authority. Counsel for the appellants emphasised passages in the authorities to the effect that "[t]he nature or quality of the obligations is critical", but none of these passages support the proposition that a covenant between a creditor and a co-surety affects the co-surety's continuing liability to a claim for contribution from another co-surety. The appellants have pointed to no decided case or dicta which support the notion that a right to contribution can be defeated by an agreement between a creditor and a co-surety that the creditor will not pursue legal action against the co-surety.

4 That the Bank was barred from enforcing the appellants' liability by action did not extinguish the appellants' liability to the Bank and did not alter the appellants' obligations vis-à-vis the respondents. As Glanville Williams said:

> "The right of contribution among co-debtors is independent of any present right of the principal creditor. Thus the right of contribution exists although

> the right of the principal [creditor] has become statute-barred, or (it is submitted) merged by judgment against one debtor".

While the Bank's covenant not to sue meant that the liability of the appellants was not enforceable by legal proceedings, it remained enforceable by other means such as reliance on rights of recoupment under other securities (if any) between the Bank and the appellants. Because the appellants were, and remained, liable under the guarantee, the appellants and respondents shared coordinate liabilities, which entitled the respondents to recover contribution. Another novel aspect of the appellants' argument was their insistence that the existence of coordinate liabilities, and the gaining of a benefit by the payment of the co-surety claiming contribution, are necessarily separate and distinct elements of a right of action for contribution. Once again, the appellants have pointed to no decided case or dicta supporting that contention. Once it is understood that the concern of the doctrine is to ensure that the burden of a common liability is borne equally, it can be seen that the existence of coordinate liabilities and benefit from payment are not separate and distinct elements of the right. When a common liability is discharged by a surety, the discharge of the liability inevitably benefits a co-surety in that, without a right of contribution in the surety, the co-surety who pays less than his or her fair share is unjustly enriched. As was said by McHugh J in *Burke v LFOT Pty Ltd*:

> "An order of contribution prevents the injustice that would otherwise flow to the plaintiff by the defendant being enriched at the plaintiff's expense in circumstances where they have a common obligation to meet the liability which the plaintiff has met or will have to meet."

Finally under this heading, as a practical matter, the suggestion that the appellants received no benefit from the respondents' discharge of the balance of the debt sits ill with cl 8(c) of the deed. The terms of this provision suggest that the prospect of the recovery of full payment from the respondents had a positive effect upon the Bank's willingness to give the appellants the benefit of the covenant not to sue.

Contribution in equity

Counsel for the respondents submitted that this case does not call for an exploration of the outer limits of the availability of contribution between co-sureties, but is a clear case for contribution. That submission is correct, and that may explain why, as Leeming JA noted, in no case prior to *Carr v Thomas* has the precise question presented by this case arisen for decision. However that may be, the irresistible strength of the respondents' case is readily apparent when the question is viewed through the lens of equity.

In *Craythorne v Swinburne*, it was made clear that once a creditor calls upon co-sureties to pay the guaranteed debt, the right of a co-surety to contribution cannot be defeated by the acts of the creditor. In that case, Lord Eldon LC said:

> "Upon the relation of principal and surety some things are very clear. It has been long settled, that, if there are co-sureties by the same instrument,

and the creditor calls upon either of them to pay the principal debt, or any part of it, that surety has a right in this Court, either upon a principle of equity, or upon contract, to call upon his co-surety for contribution ...

[W]hether [co-sureties] are bound by several instruments, or not, whether the fact is or is not known, whether the number is more or less, the principle of Equity operates in both cases; upon the maxim, that equality is Equity: *the creditor, who can call upon all, shall not be at liberty to fix one with payment of the whole debt; and upon the principle, requiring him to do justice, if he will not, the Court will do it for him*." (emphasis added)

5 More recently, in *Friend v Brooker*, French CJ, Gummow, Hayne and Bell JJ said:

"With a claim to contribution, as is the position generally with the intervention of equity to apply its doctrines or to afford its remedies, the plaintiff must show the presence of 'an equity' founding the case for that intervention. The 'natural justice' in the provision of a remedy for contribution is the concern that the common exposure of the obligors (or 'debtors') to the obligee (or 'creditor') and the equality of burden should not be disturbed or be defeated by the accident or chance that the creditor has selected or may select one or some rather than all for recovery. Were equity not to intervene, then it would remain within the power of the creditor so to act as to cause one debtor to be relieved of a responsibility shared with another. Equity follows the law in the sense that it does not seek to direct the manner of exercise of the rights of the creditor, but equity does make an adjustment between the debtors. Thus equity does not interfere with the action of the creditor but seeks to ensure the sharing of the burden between those subjected to it.

The equity to seek contribution arises because the exercise of the rights of the obligee or creditor ought not to disadvantage some of those bearing a common burden; the equity does not arise merely because all the obligors derive a benefit from a payment by one or more of them. As explained in United States authority, contribution is an attempt by equity to distribute equally, among those having a common obligation, the burden of performing it, so that without that common obligation there can be no claim for contribution."

At the heart of the appellants' argument is an invitation to accept that it is in "the power of the creditor to select his own victim; and, upon motives of mere caprice or favouritism, to make a common burden a most gross personal oppression." That invitation cannot be accepted. In the present case, the Bank's covenant not to sue the

appellants is the very kind of preferential treatment of a co-surety by a creditor that the "principle of Equity" referred to by Lord Eldon LC serves to prevent.

6 The appellants' argument, in focusing upon the timing of the respondents' payment of the guaranteed debt after the giving of the covenant not to sue, was premised on the notion that the respondents' right to contribution arose only upon payment by the respondents of more than their fair share of the guaranteed debt. This premise reflects the approach of the common law to the pleading and proof of the elements of a cause of action for the payment of money; but it does not reflect the approach of equity. In particular, it takes an unduly narrow view of the extent to which a court of equity will recognise, protect and enforce the equity to seek contribution.

7 It may be accepted that, in an action at common law, payment of a disproportionate amount is an essential element of the payer's cause of action against a co-surety for payment of money by way of contribution; but equity recognises and protects the co-surety's equity to contribution in a more flexible and comprehensive way.

8 In *McLean v Discount and Finance Ltd*, Starke J said:

> "At common law, no doubt, a surety could not maintain an action for contribution or money paid until he had actually paid more than his just proportion of the principal debt. But the authorities support the view that in equity the right to contribution can be declared before actual payment is made or loss sustained provided that such payment or loss is imminent."

9 In *Friend v Brooker*, French CJ, Gummow, Hayne and Bell JJ said:

> "In *McLean v Discount and Finance Ltd* Starke J explained that at common law an action for contribution cannot be maintained in advance of actual payment of more than the just proportion of the principal obligation; on the other hand, equity acts quia timet where the apprehended over-payment appears sufficiently imminent."

10 In the present case, the commencement of proceedings by the Bank removed any question as to whether enforcement of the respondents' liability to the Bank was imminent.

11 While in an action at common law payment by the surety is an essential element of the right of action for payment of money, in equity the issue is whether, and the extent to which, an equity to contribution is enforceable. The extent of any equitable right or entitlement has been said to be commensurate with the orders which a court of equity may make to protect or enforce the right or entitlement. It may be accepted that the respondents would not have been entitled to an order for payment of contribution from the appellants until they had paid more than their fair share of the guaranteed debt. But from the time the appellants and respondents were called upon under the guarantee, the respondents' equity to recover contribution was

sufficiently cognisable that it could not be defeated by the very kind of dealing between creditor and co-surety that the equitable principle seeks to prevent.

12 Prior to the Bank's covenant not to sue and the payment of the guaranteed debt, the respondents' equity was sufficiently cognisable in a court of equity to support a declaration that the appellants were obliged to make contribution to the discharge of the guaranteed debt. In this regard, the plurality in *Friend v Brooker* said:

> "[I]n *Woolmington v Bronze Lamp Restaurant Pty Ltd*, Needham J, whose opinion in such matters deserves great weight, said that as the authorities then stood, none had gone to the length of deciding that the plaintiff surety could maintain an equity suit for contribution without either having paid at least the amount due by the plaintiff under the guarantee or being under a liability by judgment to pay the full amount. However, Needham J was prepared to go so far as to make a declaration and order for contribution in favour of a surety who satisfied the court that he was willing able and prepared to pay at least his share of the principal debt. In the case before him, this was not so and relief was refused."

13 No doubt any declaration of the respondents' right to actual payment by the appellants would have been conditioned upon the respondents themselves meeting their obligations under the guarantee or proving their readiness, willingness and ability to do so. But to say this is merely to recognise that a plaintiff must do equity when seeking equity. It is not to suggest that a plaintiff's equity may be defeated by dealings between creditor and co-surety.

Conclusion

14 The appeal should be dismissed with costs.