Article Information

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The liabilities of co-sureties

The High Court contributes to the debate on the division of liabilities between co-sureties.

Due to the current state of the economy, companies and particularly banks have been seeking to enforce on guarantees against sureties more than ever. This has given rise to debate as to whether co-sureties can exclude themselves for liability under the guarantee. This has been examined recently by the High Court in the case of Lavin v Toppi. In this case the surety who paid a creditor a disproportionate amount of a guaranteed debt sought to recover contribution from a co-surety. The co-surety argued they were not liable to pay as they had received a covenant not to sue for payment of the guaranteed debt from the creditor, which they argued extinguished their liablity to pay the contribution sought.

Facts

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

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

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.

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

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 according to the Trade Practices Act 1974 (Cth) or unjust within the meaning of the Contracts Review Act 1980 (NSW).

On 8 September 2010, the appellants and the bank entered into a deed of release and settlement in relation to the proceedings between them. In clause 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).

In clause 8(a) of the deed, the appellants agreed to release the bank from all claims in respect of the guarantee; and, in clause 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.

Clause 8(b) of the deed also provided for the filing of consent judgments following payment of the settlement sum dismissing:

- the bank's claim against the appellants
- the appellants' cross-claim against the bank.

Clause 8(c) of the deed provided:

Nothing in this deed, compromises, prejudices or affects NAB's rights against Neil Cunningham, Paola Toppi, Luxe Productions Pty Ltd … and/or Luxe … whatsoever, including without limitation in respect of the Guarantee.

The bank was paid the settlement sum and the proceedings between the bank and the appellants were dismissed by consent.

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

Proceedings

The respondents commenced proceedings in the Equity Division of the Supreme Court of New South Wales claiming contribution from the appellants for $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 defended the claim on the grounds that the appellants and the respondents were not under "co-ordinate liabilities", that is 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.

Decision of the Supreme Court and Court of Appeal

Justice Rein of the Supreme Court of NSW held that he was bound by the NSW Court of Appeal decision of *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. The appellants were ordered to pay contribution.

The NSW Court of Appeal upheld the Supreme Court decision stating that the decision in *Carr v Thomas* was correct as a matter of principle and that the appellants and respondents continued to share liabilities of the same nature and extent. The appellants sought and were granted leave to appeal to the High Court.

Decision of the High Court

Coordinate Liabilities

The High Court held that 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. The NSW Court of Appeal was correct in holding 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.

The court held that:

- The fact 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.
- 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.

Contribution in Equity

The court held that 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.

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. The Appeal was dismissed.

The decision of the High Court is a timely reminder about the nature of the right of contribution between co-sureties. Many businesses have their operations supported by directors guarantees (a guarantee under a lease, a guarantee in support of credit facilities and the like) and the decision in Lavin v Toppi indicates that despite the action taken by the party enforcing the guarantee, the law considers it desirable that each co-surety contribute equally between them the amounts sought and paid under the guarantee.