Contribution from co-sureties

Marcel Fernandes reports on *Lavin v Toppi* [2015] HCA 4.

Ms Lavin and Ms Toppi were co-sureties who jointly and severally guaranteed a company's loan from a bank. After the bank called on the guarantees and had commenced proceedings against the co-sureties, Ms Lavin settled with the bank for an amount less than half of the amount owed to the bank and obtained a covenant from the bank not to sue. Ms Toppi later discharged the balance, being more than half of the amount owing. Ms Toppi commenced proceedings for contribution against Ms Lavin for the shortfall. Ms Lavin resisted on the basis that her and Ms Toppi's liabilities as co-sureties were not coordinate because of the covenant not to sue.

Litigation history

At first instance[1] Ms Toppi succeeded. Rein J applied *Carr v Thomas*[2] to the effect that the covenant not to sue enjoyed by one co-surety did not deprive the other co-surety who has repaid the debt of the right to seek contribution and did not render the co-sureties' respective liabilities non-coordinate.

On appeal,[3] Ms Lavin's appeal was dismissed. Leeming JA, with whom Macfarlan and Emmett JJA agreed, reasoned that the covenant not to sue did not render the co-sureties' liabilities anything other than coordinate. A covenant not to sue, as a mere 'promise in respect of [the] primary liability'[4] will (usually) not alter or extinguish that liability or the underlying cause of action founded on it. Rather, it will only prevent, as a matter of contract, action being taken in respect of the liability or cause of action, neither of which is extinguished.[5] That is the premise of the covenant not to sue: that the liability continues to exist and a promise is made in relation to it. That is so even though the covenant may be pleaded in bar as a release or used as an equitable defence enforceable by injunction, if the covenantor pursues the underlying cause of action in breach of the covenant.[6] Thus, the bank's covenant with Ms Lavin did not alter the liabilities Ms Lavin and Ms Toppi both had as between themselves, which accordingly remained coordinate.[7]

Leeming JA noted that the right in equity to contribution of a co-surety in respect of coordinate liabilities arises before that co-surety had paid more than its fair share, whereas at common law the right to contribution arises in a co-surety only *after* that co-surety has paid more than its fair share. Ms Toppi had a right to contribution at least from when the bank demanded the whole amount of the company's debt from her and commenced proceedings against her.[8]

His Honour held further that it was not necessary for the resolution of the appeal 'to identify with precision the circumstances when relief is available in advance of payment, which at least in part reflects equity's power to grant relief *quia timet*'.[9] In the result, Ms Toppi's existing right to contribution could not have been lost by Ms Lavin settling with the bank.[10] In general, the right to contribution may be qualified or excluded by contract.[11] As such, it was necessary to construe the guarantee to see whether it altered the position. Here, it did not do so.

High Court

The High Court dismissed the appeal in a unanimous judgment (French CJ, Kiefel, Bell, Gageler and Keane JJ). The High Court agreed that the bank's covenant not to sue Ms Lavin did not release her from liability under the guarantee; the co-sureties continued to share coordinate liabilities under the guarantee and Ms Toppi had a right of contribution. The High Court stated that '[i]n addition, the Court of Appeal's conclusion is supported by a broader equitable view of the rights of co-sureties between each other'.[12] That broader view was that a co-surety's right to contribution 'was cognisable in equity even before [Ms Toppi] made [her] disproportionate payment' to the bank.[13]

The court held that from the moment the debtor company defaulted upon its loan to the bank, or at least from when the bank made demands of the guarantors, both Ms Lavin and Ms Toppi were 'under a common obligation' to pay the whole of the debt.[14] The court noted that '[t]he utility of the device of the covenant not to sue is that it does not discharge the liability of the covenantee under the guarantee'. This preserved the creditor's rights against other sureties since if a creditor releases one surety, all are released.[15] Accordingly, the covenant not to sue did not alter the liability.

The court noted that equity's recognition of the right to contribution before disproportionate payment is based on equity's ability to act *quia timet*. Thus, the equitable right to contribution will arise where a disproportionate payment by a co-surety, and thus that co-surety's loss, is 'imminent'[16] or 'sufficiently imminent'.[17] In contrast, the common law right to contribution arose only after disproportionate payment; such payment was 'an essential element of the right'.[18]

Here, there was clearly sufficient imminence from when the bank commenced proceedings against the co-sureties.[19] This was enough to dispose of the proceedings, since that occurred before the covenant not to sue was agreed.

The court commented further that the earliest time at which there was sufficient imminence was when the co-sureties 'were

called upon under the guarantee',[20] since at that time Ms Toppi's 'equity to recover contribution was sufficiently cognisable'. However, if Ms Toppi had at that time sought a declaration as to her right to equitable contribution, she would only have been entitled to one if she had been at least able to prove she was ready, willing and able to 'do equity' by paying her share of the principal debt.[21]

Conclusion

The case, with its simple factual scenario, provides a satisfying illustration of a principle of long-standing, confirming it to apply to the particular circumstance of a covenant not to sue. As Lord Eldon LC said,[22] quoted by the High Court:[23]

> [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.*

Endnotes

1. *Toppi v Lavin* [2013] NSWSC 1361.
2. [2009] NSWCA 208.
3. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598.
4. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [73].
5. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [74].
6. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [73].
7. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [74].
8. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [46] – [47].
9. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [47].
10. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [48].
11. *Lavin v Toppi* [2014] NSWCA 160; (2014) 308 ALR 598 at [53]-[54].
12. *Lavin v Toppi* [2015] HCA 4 at [3].
13. *Lavin v Toppi* [2015] HCA 4 at [31].
14. *Lavin v Toppi* [2015] HCA 4 at [36].
15. *Lavin v Toppi* [2015] HCA 4 at [37], citing *Bateson v Gosling* (1871) LR 7 CP 9; *Murray-Oates v Jjadd Pty Ltd* (1999) 76 SASR 38 at 53 [83].
16. *McLean v Discount and Finance Ltd* (1939) 64 CLR 312 at 341, per Starke J.
17. *Friend v Brooker* (2009) 239 CLR 129 at [57].
18. *Lavin v Toppi* [2015] HCA 4 at [52].
19. *Lavin v Toppi* [2015] HCA 4 at [51].
20. *Lavin v Toppi* [2015] HCA 4 at [52].
21. *Lavin v Toppi* [2015] HCA 4 at [54].
22. *Craythorne v Swinburne* [1807] EngR 343; (1807) 14 Ves Jun 160 at 164-5; 33 ER 482 at 483-484 (emphasis added).
23. *Lavin v Toppi* [2015] HCA 4 at [44] – emphasis in original.