IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY **No. S258 of 2014**

BETWEEN:

DOLORES LAVIN
First Appellant

DOLORES LAVIN MANAGEMENT PTY LIMITED ACN 077 840 003
Second Appellant

and

PAOLA TOPPI
First Respondent

NEIL CUNNINGHAM
Second Respondent

BASECOVE PTY LIMITED ACN 074 145 261
Third Respondent

APPELLANTS' SUBMISSIONS

Part I: Suitability for publication

1. The Appellants certify that these submissions are in a form suitable for publication on the internet.

Part II: Issues

2. Does the receipt from a creditor by one of a number of co-sureties of a covenant not to sue have any, and if so what, effect upon rights of contribution which might otherwise arise between the co-sureties?

3. Does a co-surety, having obtained from the creditor a covenant not to sue, share with other co-sureties co-ordinate liabilities of the same nature and to the same extent, so as to give rise to a right to contribution as between the co-sureties?

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4. Does the doctrine of contribution require that the burden arising from a payment by the plaintiff co-surety be accompanied by a corresponding benefit accruing to the defendant co-surety? If so, is there any practical or relevant benefit which accrues to the defendant co-surety in receipt of a covenant not to sue, by reason of a payment made by the plaintiff co-surety?

Part III: Judiciary Act 1903, s.78B

5. The Appellants have considered whether notice should be given pursuant to s.78B of the *Judiciary Act* and have formed the view that no such notice is required.

Part IV: Decisions below

10 6. The decision at [2013] NSWSC 1361 is unreported. The decision of the New South Wales Court of Appeal is reported at (2014) 308 ALR 598.

Part V: Facts

7. The First Appellant Ms Lavin and First Respondent Ms Toppi were the principals of Luxe Studios Pty Limited ("Luxe Studios"), which in 2005 purchased a property at 279-283 Liverpool Street, Sydney for the purposes of conducting photographic studios. The purchase was funded by initial advances of $4.29 million from National Australia Bank Limited ("the Bank"), which subsequently provided further funding to permit renovations to the property.

8. The Bank loans were secured by a suite of mortgages and guarantees given on the one
20 hand by the Appellants and related entities and on the other hand by the Respondents and related entities. In 2008, the numerous loans and facilities provided by the Bank

were consolidated into one loan and a further guarantee was obtained in October 2008 ("the 2008 Guarantee") from the Appellants and the Respondents .

9. In March 2010, the Bank made demand upon the various guarantors for payment of its debt (then $7.8 million) and soon after commenced Supreme Court proceedings to recover the debt. The Appellants , but *not* the Respondents , filed a cross-claim against the Bank (seeking relief upon the basis that the 2008 Guarantee had been procured in circumstances that were unconscionable within the meaning of the *Trade Practices Act 1975 (Cth)* and also that the 2008 Guarantee was an unjust contract).

10. On 8 September 2010, the Appellants settled the proceedings against them by entering into a deed of settlement with the Bank ("the Deed") pursuant to which:-

10.1 the parties agreed that the Appellants' cross-claim ought be dismissed and that, upon payment by the Appellants to the Bank of $1.35 million, the Bank's proceedings against the Appellants would be dismissed: clause 7(b), (e);

10.2 the Bank (subject to its receipt of the settlement monies) covenanted not to make any claim against the Appellants in respect of the 2008 Guarantee or any matter arising in or out of the Bank's proceedings: clause 8(b);

10.3 the parties agreed that nothing in the Deed would prejudice or affect the Bank's rights against the Respondents: clause 8(c).

11. On 21 September 2010, the cross-claim filed by the Appellants was dismissed and on 13 December 2010, following payment of $1.35 million by the Appellants, the Bank's proceedings against them were dismissed.

12. Following the sale of Luxe Studios' Liverpool Street property and other properties, the Respondents paid to the Bank in February 2011 the net balance then due of approximately $2.9 million. They then sued to recover from the Appellants by way of contribution approximately $800,000, being half the difference between the amounts paid to the Bank by the respective parties.

13. The primary judge concluded that he was bound by the decision of the New South Wales Court of Appeal in *Carr v Thomas* [2009] NSWCA 208 to hold that the Respondents were entitled to contribution. In the course of doing so, he rejected submissions of the Appellants to the effect *inter alia* that:-

10 13.1 having regard to the covenant not to sue given to the Appellants by the Bank in the Deed of 2010, the respective liabilities of the Appellants and the Respondents were not "co-ordinate" as required for contribution.

13.2 the Appellants, as the recipients of the covenant not to sue, derived no relevant benefit from the subsequent payment by the co-guarantors.

14. In the Court of Appeal, Leeming JA (with whom Macfarlan JA and Emmett JA agreed) relevantly concluded that:-

14.1 the authorities upon which the Court of Appeal had relied in *Carr v Thomas* did not squarely address the requirements for contribution [55];

14.2 despite statements in the texts and dicta in the authorities in support of the
20 unaffected right of contribution, it was necessary to address the question at the level of principle [72];

14.3 the Respondents enjoyed a right to contribution no later than at the time that the Bank made demand or commenced proceedings [46]-[47], and that such right to contribution could not be "lost" by reason of subsequent events (including the receipt by the Appellants of the covenant not to sue) [48];

14.4 because the liability to the creditor was not itself "removed" by the covenant not to sue,

(i) the liabilities were of the same nature and to the same extent [74]; and

(ii) the Respondents' payment did confer a benefit upon the Appellants , in that their ongoing "liability" to pay the guaranteed debt ceased to exist after the Respondents' payment [76].

15. The Court of Appeal erred in each of the respects identified in the last paragraph.

Part VI: Argument

16. In neither *Carr v Thomas* nor the decision under appeal does the Court of Appeal's reasoning sufficiently address the requirements for application of the doctrine of contribution definitively stated in this Court's recent decisions in *Burke v LFOT Pty Limited* (2002) 209 CLR 282, *Friend v Brooker* (2009) 239 CLR 129 and *HIH Claims Support Limited v Insurance Australia Limited* (2011) 244 CLR 72.

17. In light of the principles enunciated in these authorities, the decision below is erroneous at three levels:-

17.1 The doctrine of contribution requires that the parties share co-ordinate liabilities to make good the one loss, and that those liabilities be of the same nature and to the same extent; however, the liabilities of co-sureties, from one

of whom the principal debt cannot be recovered but the other of whom has a liability "at large", are not liabilities of the same nature and to the same extent.

17.2 The Court of Appeal erred in concluding that the right of contribution arises as at the date (at the latest) on which the creditor makes demand of, or commences proceedings against, the co-sureties; rather, the right arises once one co-surety has paid or become liable to pay more than his or her proper share of the common liability.

17.3 The doctrine requires for its operation equality of burden and benefit; however, no relevant benefit is derived by a co-surety in receipt of a covenant not to sue.

A. Co-ordinate liabilities

18. A right of contribution may arise at common law when one of several debtors has paid more than his or her proper share towards the discharge of the common obligation or liability; and in equity the right may arise once the liability of one of several debtors to pay more than a fair or proper share has been ascertained. [1]

19. The circumstances in which a right of contribution *will* arise were considered by this Court in *Burke v LFOT Pty Limited*[2] (in which a vendor of retail premises found to have misled its purchaser sought contribution from the purchaser's solicitor); Gaudron A-CJ and Hayne J (at [15]) identified as a requirement for contribution that debtors share co-ordinate liabilities or a common obligation to make good the one loss, and

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[1] *McLean v Discount and Finance Limited* (1939) 64 CLR 312 at 341 per Starke J (a case concerning co-sureties); *Albion Insurance Company Limited v Government Insurance Office of New South Wales* (1969) 121 CLR 342 at 351-352 per Kitto J; *Friend v Brooker* (2009) 239 CLR 129 at [52] per French CJ, Gummow Hayne and Bell JJ

[2] *Burke v LFOT* (2002) 209 CLR 282

further that the respective liabilities of the co-obligors be *"of the same nature and to the same extent"*. The need for the obligations to be of the same nature and extent was also endorsed by McHugh J (at [38], [49]). McHugh J (at [49]-[50]) cited in support of this *"basal principle"* the statement of Lord Ross in *BP Petroleum Development Limited v Esso Petroleum Co Limited* that:-

> "[T]he origins of the obligation placed on the pursuers and the defenders are separate and distinct, *but the obligation is a common one because each has to perform substantially the same obligation"*.[3]

10 20. In *Friend v Brooker,* the plurality restated (at [40]) the proposition that the "basic characteristics" of the doctrine (as identified in *Burke*) require –

> "contribution between parties sharing co-ordinate liabilities or a common obligation to make good the one loss, where the liabilities were of the same nature and to the same extent".

The plurality also considered in *Friend* (at [41]) that the expression "co-ordinate liabilities" was to be preferred to that of "common obligation" as indicative of the class of circumstances in which the equity for contribution arises.

21. The plurality in *HIH Claims Support Limited v Insurance Australia Limited*[4]
20 considered (at [39]) that the search for co-ordinate liabilities could be satisfied, even where the respective obligations had a different source, provided the obligations could be characterised as "of the same nature and to the same extent". Importantly, their Honours went on to observe (at [55]):-

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[3] [1987] SLT 345 at 348 (emphasis added by McHugh J)
[4] *HIH Claims v Insurance Australia* (2011) 244 CLR 72

> "A 'community of interest' between obligors is not a sufficient condition for the operation of an equity to contribute in circumstances where the obligations in question are qualitatively different..."

22. It was this qualitative assessment of the respective obligations of the Appellants and Respondents which Leeming JA failed to undertake. Had his Honour done so, he ought to have concluded that the liability of the Appellants which, following their receipt of the covenant not to sue, was unenforceable and irrecoverable at the suit of the Bank, was not a liability of the same nature and extent as that of the Respondents.

23. Instead, Leeming JA (at [74]) answered the question whether the respective liabilities were "co-ordinate" by concluding in effect that, because the covenant not to sue did not alter the Appellants' *liability*, there remained a "community of interest" between the Appellants and Respondents sufficient to require contribution. His Honour did not, however, take the critical and necessary step of ascertaining whether the two remaining liabilities were, or were not, of like nature and extent.

24. In truth, although the liability of each of the co-sureties may have remained, they were of distinctly different nature and extent. Following their receipt of the covenant not to sue, the Appellants' liability was unenforceable and irrecoverable by the creditor, which was then left with a "right without remedy"[5]. Moreover, it could not be said (to adopt the terminology applied by McHugh J in *Burke*[6]) that the *obligation* was common to the claimant and defendant, "*because each has to perform substantially the same obligation*".

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[5] *McKenna v Austin* (1943) 134 F.2d 659 at 661; cf *Ashby v White* (1703) 2 Ld Raym 938 at 953 [92 ER 126 at 136] cited in *Dietrich v R* (1992) 177 CLR 292 at 356 per Toohey J and *APLA Limited v Legal Services Commissioner of New South Wales* (2005) 224 CLR 322 at [255], [312] per Kirby J

[6] *Burke v LFOT* 209 CLR 282 at 303 [49]

25. Here, the Appellants and Respondents did not have to perform substantially the same obligation. Following receipt of the covenant, the Appellants had an obligation which they were not intended to fulfill; it was not one which they could be compelled to perform at all. In contrast, the Respondents' liability as surety for the remaining debt was entire and complete.

26. Critically, the respective liabilities of the parties were "*qualitatively different*": *HIH Claims Support Limited v Insurance Australia Limited* (2011) 244 CLR 72 at 92 [55] per Gummow A-CJ, Hayne, Crennan and Kiefel JJ. The risk to the Appellants of having to make payment was non-existent, whereas the Respondents' risk was unlimited. Accordingly, the liabilities were not of the same nature nor to the same extent, so that the claimed right to contribution did not arise.[7]

27. The failure of the primary judge and Court of Appeal to undertake *any* relevant qualitative assessment vitiated the decisions below. For the same reason, statements in the authorities and texts relied upon by the Court of Appeal in *Carr v Thomas*[8] and discussed by Leeming JA (at [55]-[72]) – to the general effect that a covenant not to sue will not affect rights of contribution – have not followed upon analysis of the issues as now required by the enunciation of principle in the three recent decisions in this Court, and they cannot be regarded as determinative of the issue.

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[7] The question asked by Bray CJ in *Floreani Bros. Pty Limited v Woolscourers (S.A.) Pty Limited* (1976) 13 SASR 313 at 322 is entirely apposite: "*Surely the defendant would be entitled to say: 'The common creditor could not have sued me or otherwise compelled me to pay or subjected me to any disability in respect of this debt at this time. How then can you?' "*

[8] [2009] NSWCA 208

B. When does the right of contribution arise?

28. The primary judge considered that the requirement for co-ordinate liabilities was satisfied in the case of co-sureties by reason of their execution of the same guarantee[9]. In the Court of Appeal, Leeming JA concluded (at [46]-[47]) that the Respondents enjoyed a right to contribution no later than at the time the Bank made demand or commenced proceedings; and he concluded (at [48]) that that right could not be "lost" by reason of subsequent events (including the Appellants' receipt of the covenant not to sue). Neither view is correct.

29. Firstly, as earlier indicated, the right to contribution arises when one co-surety pays more than his or her proper share towards the discharge of the common obligation or liability, although the right may be recognised in equity once the liability to pay more than a fair or proper share has been ascertained[10]. Because contribution is required to achieve equality of burden between the co-sureties, contribution will not be ordered until it can be determined that one has paid (or will pay) more than a fair share – that cannot be determined at the time of the guarantee, or of any demand or commencement of proceedings on the part of the creditor. Here (and in the usual case), whether the plaintiff co-surety will have paid more than a fair share of the creditor's debt is not ascertainable until payment is made.

30. Secondly, the recent decisions of this Court make clear that contribution requires that there be both burden and benefit; "the discharge of the burden by one party constitutes

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[9] *Toppi v Lavin* [2013] NSWSC 1361 at [22]

[10] *McLean v Discount and Finance* 64 CLR 312 at 341; *Albion v Government Insurance Office* 121 CLR at 351-352; *Friend v Brooker* 239 CLR 129 at 133 [52]; and see *Davies v Humphreys* (1840) 6 M & W 153 at 168-9; 151 ER 361 at 367-8

a benefit to the other"[11]. However, if, as held below (at [47]), the right to contribution arises no later than the commencement of proceedings, then any requirement for both burden and benefit will have become entirely otiose.

C. The requirement for benefit

31. In both *Burke* and *Friend,* this Court recognised that critical to the operation of the doctrine of contribution is the identification of a *benefit* received by the co-obligor as a result of the payment said to give rise to the contribution sought. In *Burke*, McHugh J identified the injustice prevented by an order for contribution as that which would otherwise flow to the plaintiff by the defendant being enriched at the plaintiff's
10 expense (at [38]); and he stressed (at [41]) that the interests of the co-obligors must be–

> "such that the discharge of the burden by one party constitutes a benefit to the other or others which, in fairness, the law cannot countenance them keeping".

32. Subsequently, in *Friend,* the plurality again identified (at [39], [44], [49]) the necessity (at a minimum) that there be a benefit to the defendant co-surety arising from the discharge of burden by the claiming co-surety.

33. The error below was the acceptance of the claim for contribution in circumstances
20 where it was not shown, and could not be shown, that the Respondents' payment in 2011, on which their claim for contribution was based, produced any relevant benefit or advantage for the Appellants. The "benefit" asserted by Leeming JA (at [76]),

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[11] *Burke v LFOT* (2002) 209 CLR 282 at 300 [41] per McHugh J; *Friend v Brooker* (2009) CLR 129 at 149-150 [44] per French CJ, Gummow, Hayne and Bell JJ, citing *Bonner v Tottenham and Edmonton Permanent Investment Building Society* [1899] 1 QB 161 at 174 (see also 176, 177); *HIH Claims v Insurance Australia* (2011) 244 CLR 72 at 87 [37] footnote (85) per Gummow A-CJ, Hayne, Crennan and Kiefel JJ

namely that after the Respondents' payment there was no guaranteed debt left for the Appellants to pay, was in reality illusory. This was because, having obtained the covenant not to sue (and dismissal of the proceedings against them), the Appellants were no longer susceptible to perform any obligation to pay the Bank. They received no practical benefit as a result of the payment made by the Respondents; their assets were no less exposed. Nor were they relieved of any enforceable obligation, present or future, certain or contingent, to the Bank. Thus, there was no enrichment for which equity would require some accounting.

34. As equity looks to substance and not form when fixing the situation of the parties in such circumstances[12], any "benefit" to be derived from the discharge of ongoing "liability" of the Appellants was merely hypothetical and of no practical significance.

35. For the same reasons, after 2010 there was no extant "community of interest" between the Appellants and Respondents sufficient to support a right of contribution.

D. Other Considerations

36. Both at first instance[13] and on appeal[14], a result which prevented one surety "*from being able to saddle other sureties with a disproportionate amount of liability*" was seen as having "considerable attraction".

37. However, the outcome below, which leaves the surety who reaches an arm's length commercial resolution of proceedings brought by the principal creditor exposed to

[12] *Friend v Brooker* (2009) 239 CLR 129 at [47]
[13] *Toppi v Lavin* [2013] NSWSC 1361 at [17]
[14] *Lavin v Toppi* (2014) 308 ALR 598 at [49] per Leeming JA

further litigation at the suit of a co-surety, is unattractive as a matter of policy, for it is apt to create a disincentive to settlement in the first place.

38. Further, the potential for disproportionate contributions by the co-sureties was in this case acknowledged by the Respondents when they executed the 2008 Guarantee. By clause 14.2, they recognised that compromise by the Bank with the Appellants would leave their own liability to the Bank unaffected (clause 14.2(c)(iii)) and that all or part of the principal debt might not be recoverable from the Appellants in such a case (clause 14.2(i)).

Part VII: Statutes and Regulations

10 39. There are no relevant statutes and regulations to which the Appellants wish to refer.

Part VIII: Orders Sought

40. The Appellants seek the following orders:

1. Appeal allowed with costs.

2. Judgment of the Court of Appeal dated 23 May 2014 be set aside.

3. In lieu thereof, it be ordered that the Appellants' appeal to that Court be allowed with costs.

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Part IX: Time Estimate

41. It is estimated that the presentation of the Appellants' oral argument would take no more than two hours.

Dated: 16 October 2014

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