HIGH COURT OF AUSTRALIA

GUMMOW, HAYNE, HEYDON, KIEFEL AND BELL JJ

RONALD JOHN BOFINGER & ANOR — APPELLANTS

AND

KINGSWAY GROUP LIMITED FORMERLY WILLIS & BOWRING MORTGAGE INVESTMENTS LIMITED & ORS — RESPONDENTS

Bofinger v Kingsway Group Limited [2009] HCA 44
13 October 2009
S161/2009

ORDER

1. *Appeal allowed.*

2. *Set aside order 1 of the orders of the Court of Appeal of the Supreme Court of New South Wales entered 29 December 2008 and the orders of the Court of Appeal entered 8 July 2009 and in place thereof order that:*

   (a) *appeal allowed;*

   (b) *orders 1 and 2 of the orders made by Young CJ in Eq, entered 18 February 2008 be set aside; and*

   (c) *the separate question stated on 16 November 2006 be answered as follows:*

   Question: In the circumstances of the case, were the sums of $268,307.33 and $432,712.53 and the securities over Lots 1 and 14 SP75069 held by the second defendant in trust for the plaintiffs as at 8 February 2006?

   Answer: In the absence of prior consent or release by Mr and Mrs Bofinger, on 8 February 2006 Kingsway Group Limited was obliged to account to Mr and Mrs Bofinger as a constructive trustee for any dealing by it with the moneys and securities identified in the question for decision in favour of any other party, and to pay equitable compensation to Mr and Mrs Bofinger in respect of the

denial or limitation by such dealing of recoupment from those moneys and securities of moneys paid by Mr and Mrs Bofinger to Kingsway Group Limited, in total $1,519,234.40, from the proceeds of sale of their properties at 407 Willarong Road, Caringbah and 2/41 Bulwarra Street, Caringbah.

3. *The first, second, fifth, sixth, seventh and eighth respondents pay the appellants' costs in this Court, in the Court of Appeal and of the proceedings to date in the Equity Division of the Supreme Court of New South Wales.*

On appeal from the Supreme Court of New South Wales

Representation

G J McVay with A Tsekouras for the appellants (instructed by Warren McKeon Dickson Solicitors)

D R Sibtain with C K Amato for the first and eighth respondents (instructed by Watson Mangioni)

C M Harris SC with H P T Bevan for the second respondent (instructed by Bransgroves Lawyers)

R J H Darke SC with G K J Rich for the fifth to seventh respondents (instructed by Middletons Lawyers)

Submitting appearance for the third and fourth respondents

CATCHWORDS

Bofinger v Kingsway Group Limited

Guarantee and indemnity – Surety – Right to subrogation to securities – Three separate loans made to company, each secured by mortgage over company's property – Appellants guarantors of each loan – Appellants sold personal properties and used proceeds to reduce first loan – First mortgagee exercised power of sale over company's property to satisfy outstanding amounts owing under first loan and transferred surplus to second mortgagee – Whether appellants have right to subrogation to securities in priority to puisne mortgagees – Whether appellants' right to subrogation excluded by terms of guarantees to puisne mortgagees – Whether rule in *Otter v Lord Vaux* (1856) 2 K & J 650 [69 ER 943] applied to prevent appellants from exercising right to subrogation or should be extended to so apply – Whether transfer of surplus required to be unconscionable for doctrine of subrogation to apply.

Equity – Remedies – Constructive trust – Nature of constructive trust – Surplus transferred by first mortgagee to second mortgagee – Whether first mortgagee constructive trustee of surplus – Whether obligation to account.

Words and phrases – "subrogation", "unconscientious", "unconscionable", "unjust enrichment".

Statute of Frauds 1677, s 4.
Conveyancing Act 1919 (NSW), s 10.
Law Reform (Miscellaneous Provisions) Act 1965 (NSW), s 3.
Real Property Act 1900 (NSW), ss 57(1), 58.
Uniform Civil Procedure Rules 2005 (NSW), r 28.2.

1 GUMMOW, HAYNE, HEYDON, KIEFEL AND BELL JJ. The resolution of this appeal calls for application of "the cardinal principle of equity that the remedy must be fashioned to fit the nature of the case and the particular facts"[1]. The nature of the present case and the particular facts engage the law respecting sureties, their obligation to indemnify the creditor and right to indemnity by the principal debtor, and the operation of the doctrine of equity associated with the term "subrogation".

2 The appellants (Mr and Mrs Bofinger) are husband and wife. Mr Bofinger was a director of B & B Holdings Pty Ltd ("B & B Holdings"), which is now in liquidation. B & B Holdings borrowed consecutively from the first, second and third respondents ("first mortgagee", "second mortgagee" and "third mortgagee" respectively) on the security of mortgages over the same real property of B & B Holdings. The appellants gave guarantees to the first, second and third mortgagees. The guarantees were supported in each case by a mortgage over real property of the appellants. The appellants sold these properties and applied the proceeds in reduction of the indebtedness of B & B Holdings to the first mortgagee.

3 Thereafter, the first mortgagee exercised its power of sale over certain of the properties mortgaged by B & B Holdings. After satisfying the balance of the indebtedness of B & B Holdings, the first mortgagee accounted to the second mortgagee by payment of the surplus sale proceeds and delivery of the certificates of title and discharges of the first mortgages over two unsold properties. The first mortgagee did not, as the appellants contend it should have done, account to them so that they might recoup what they had paid off the indebtedness of B & B Holdings.

4 The right of subrogation in favour of a surety recently was described by Sir Andrew Morritt V-C as follows[2]:

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1 *Warman International Ltd v Dwyer* (1995) 182 CLR 544 at 559; [1995] HCA 18.

2 *Liberty Mutual Insurance Co (UK) Ltd v HSBC Bank plc* [2001] Lloyd's Rep Bank 224 at 225; affd [2002] EWCA Civ 691. See Andrews and Millett, *Law of Guarantees*, 5th ed (2008), §11-028 and, with respect to insurance, the statement by Kitto, Taylor and Owen JJ in *British Traders' Insurance Co Ltd v Monson* (1964) 111 CLR 86 at 94; [1964] HCA 24, that where there was no longer an outstanding right of action of the insured against a third party, "one might almost wish that some other word had been used as the label of a right which exists when it is too late for subrogation in the ordinary sense".

> "The right operates so as to confer on the surety who has paid the debt in full the rights against the debtor formerly enjoyed by the creditor *or by imposing on the creditor the obligation to account to the surety for any recovery in excess of the full amount of his debt*." (emphasis added)

That statement is important for this case because the indebtedness to the first mortgagee had been paid in full and the securities held by the first mortgagee discharged. The remedies equity provides must, as will appear, found upon the obligation of the first mortgagee to account.

5 Before proceeding it is convenient to consider further the relevant principles respecting subrogation and guarantees.

Subrogation and guarantees

6 In *Orakpo v Manson Investments Ltd*[3] Buckley LJ remarked that the relevant equitable considerations respecting a claim to subrogation may differ, for example, where the basis of subrogation is a contract of indemnity, or concerns *ultra vires* borrowings by a corporation, or the lending of funds to complete a purchase or pay off an existing mortgage. To that list may be added the subrogation of creditors of a trustee to the trustee's lien over the trust property[4]. Therefore, if for no other reason, it is unhelpful to speak of subrogation as if it were a "cause of action" in the sense recognised at common law[5].

7 In its widest sense, that apparently used by Buckley LJ in *Orakpo*, an indemnity includes a contract obliging one person to make good the loss suffered by another, and contracts of guarantee and those of insurance fall within that description. The authorities dealing with the writing requirements of s 4 of the *Statute of Frauds* 1677 with respect to guarantees (but not indemnities) sought to distinguish between guarantees and indemnities by emphasising the secondary liability of the guarantor and the primary liability of the indemnifier. But as

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3 [1977] 1 WLR 347 at 357; [1977] 1 All ER 666 at 676; affd [1978] AC 95.

4 *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367; [1979] HCA 61.

5 Cf *Boscawen v Bajwa* [1996] 1 WLR 328 at 335; [1995] 4 All ER 769 at 777; *Kation Pty Ltd v Lamru Pty Ltd* (2009) 257 ALR 336 at 340-341.

Mason CJ pointed out in *Sunbird Plaza Pty Ltd v Maloney*[6], there is in this distinction "an element of ambiguity ... unless the reference to primary liability is understood to mean ultimate liability". His Honour added[7]:

> "Once default has occurred, the party having the benefit of the guarantee can call on the guarantor to honour his promise before calling on the principal contracting party to perform his obligation, but the guarantor, having honoured his promise, can hold the principal contracting party to account by virtue of the doctrine of subrogation."

8 This notion of the ultimate liability of the principal provides a foundation for the application of subrogation in aid of the surety. Thus, where a claim to the benefit of securities held by the creditor is made by a surety, it was said by Turner V-C[8] that the equity for subrogation is derived from the obligation of the principal debtor to indemnify the surety[9]. There is "nothing hard" in the act of a court of equity in placing the surety in exactly the situation of the creditor with respect to those securities[10], because it would be unconscientious for the debtor to recover back the securities from the creditor while the debtor was obliged to indemnify the surety[11].

9 What then are the equities where the creditor holds a first mortgage and there are puisne mortgagees? The authorities hold that a second mortgagee cannot complain where the surety utilises by subrogation the security held by the first mortgagee. In *Drew v Lockett*[12] this was put on the basis that the second mortgagee took its interest with notice and by grant from the equity of

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6 (1988) 166 CLR 245 at 254; [1988] HCA 11.

7 (1988) 166 CLR 245 at 254.

8 *Yonge v Reynell* (1852) 9 Hare 809 at 818-819 [68 ER 744 at 748-749].

9 See also *O'Day v Commercial Bank of Australia Ltd* (1933) 50 CLR 200 at 223; [1933] HCA 37; *Friend v Brooker* (2009) 83 ALJR 724 at 735 [55]; 255 ALR 601 at 614; [2009] HCA 21.

10 *Duncan Fox & Co v North and South Wales Bank* (1880) 6 App Cas 1 at 12.

11 Andrews and Millett, *Law of Guarantees*, 5th ed (2008), §11-017.

12 (1863) 32 Beav 499 [55 ER 196].

redemption enjoyed by the principal debtor in its state remaining after giving full effect to the first mortgage. Thus, in de Colyar's work on guarantees it was said that the surety was entitled to all the equities the creditor could have enforced, adding[13]:

> "And this right prevails, not merely against the original creditor of the principal debtor, but also against all persons claiming under the latter[14]. A mortgaged his estate to C, and B became A's surety for the debt. Afterwards A mortgaged the estate to D, who had notice of the first mortgage. The first mortgage was subsequently paid off, partly by B, the surety, but D got a transfer of the legal estate. It was held that the surety had still priority over D for the amount paid by him under the first mortgage, as surety for A[15]. Again, on a purchase of goods by a broker for an undisclosed principal, in a market according to the usage of which such a broker is personally liable in default of his principal, and is, therefore, a surety for the latter, the unpaid vendor's lien will pass to the broker, on default made by his principal, even though the latter may have pledged his interest in the goods to the third persons, and indorsed the delivery order to them[16]."

10 The appellants in the present appeal relied, in particular, upon the statement of principle by Sir John Romilly MR in *Drew v Lockett*[17]:

> "I am of opinion that a surety who pays off the debt for which he became surety must be entitled to all the equities which the creditor, whose debts he paid off, could have enforced, not merely against the

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13 De Colyar, *A Treatise on the Law of Guarantees and of Principal and Surety*, 3rd ed (1897) at 330-331. See also *Rowlatt on Principal and Surety*, 5th ed (1999) at 160; Andrews and Millett, *Law of Guarantees*, 5th ed (2008), §11-015.

14 *Drew v Lockett* (1863) 32 Beav 499 [55 ER 196]; and see *In re Kirkwood's Estate* (1878) 1 LR Ir 108.

15 *Drew v Lockett* (1863) 32 Beav 499 [55 ER 196]; and see *In re Kirkwood's Estate* (1878) 1 LR Ir 108. [See also *Aylwin v Witty* (1861) 30 LJ Ch 860.]

16 *Imperial Bank v London and St Katharine Docks Co* (1877) 5 Ch D 195.

17 (1863) 32 Beav 499 at 505-506 [55 ER 196 at 198]. See also *In re Davison's Estate* (1893) 31 LR Ir 249 at 255.

> principal debtor, but also as against all persons claiming under him. It is to be observed that the second and any subsequent mortgagee is in no respect prejudiced by the enforcement of this equity; when he advances his money he knows perfectly well that there is a prior charge on the property, and if he thinks fit to advance his money on such security, it is his own affair, and he cannot afterwards with justice complain. The amount being limited, it is a matter of indifference to him whether the first mortgagee or the surety is the prior claimant for that amount, and it would be, in my opinion, a violation of all principle if, when the surety pays off the debt, he were not to be *entitled, as against the principal debtor and those who claim under him,* to be paid the full amount due to him." (emphasis added)

11 This statement is to be read with the earlier decision of the same judge in *Gedye v Matson*[18]. The immediate issue in that case was whether a foreclosure suit by a first mortgagee was defective for want of joinder of a surety who had paid off part of the mortgage. Sir John Romilly MR ruled that the surety "is entitled to stand in the place of the mortgagee, and is, therefore, interested in the equity of redemption ... [and] might afterwards come and redeem"[19]. He also held that the surety was "in the situation of a subsequent incumbrancer, and as if the mortgagor had executed a second mortgage to him. As against the principal debtor, the surety is entitled to a charge on the estate."[20]

12 More recently, in *Aquilina Holdings Pty Ltd v Lynndell Pty Ltd*[21] Daubney J remarked that an opposite result to that in authorities such as *Gedye v Matson* would tend to undermine the operation of the equitable doctrine of subrogation. His Honour also said that the equitable doctrine did not do violence to the principles of the Torrens system[22]. Rather, the doctrine accepts the state of the register but enforces against registered proprietors conscientious obligations

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18 (1858) 25 Beav 310 [53 ER 655].

19 (1858) 25 Beav 310 at 311 [53 ER 655 at 655].

20 (1858) 25 Beav 310 at 312 [53 ER 655 at 656].

21 [2008] QSC 57 at [74]; noted Young, "Recent cases", (2008) 82 *Australian Law Journal* 760 at 762-763.

22 [2008] QSC 57 at [53]. Cf *Westfield Management Ltd v Perpetual Trustee Co Ltd* (2007) 233 CLR 528 at 538-541 [35]-[45]; [2007] HCA 45.

imposed upon them[23]. Under the Torrens system, the charge or equitable lien of the surety would support a caveat on the subject property[24].

The present dispute

13 The respondents do not challenge these statements of principle. But by their Notices of Contention they submit that the statements do not speak to the circumstances of the present litigation. First, the debt secured by the first mortgage had been paid in full at the date when the entitlement of the appellant sureties was to be assessed and the first mortgage had been displaced on the register upon exercise of the power of sale of some of the lots and upon registration of discharges with respect to other lots. Secondly, surplus proceeds and assets had been distributed to the second mortgagee and thus had left the control of the first mortgagee. Thirdly, and unlike the situation in *Drew v Lockett*, the sureties also had guaranteed puisne mortgages and for that reason any entitlement they had in equity to the surplus would prejudice impermissibly the second and third mortgagees.

14 The appellants complain that in upholding the decision of the primary judge (Young CJ in Eq)[25] the New South Wales Court of Appeal (Giles JA, Handley AJA and Sackville AJA)[26] did not give any effect to their equity as guarantors to subrogation to the rights of the first mortgagee against B & B Holdings. This result was reached by an answer in the negative to a question posed for separate decision in a suit in the Equity Division of the Supreme Court.

15 The primary case of the appellants is that the first mortgagee had distributed the surplus in breach of the constructive trust in which the surplus was held for them as sureties. The reasons which follow lead to a conclusion which, without going to the length of accepting all of the appellants' submissions, favours allowing the appeal.

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23 See, generally, *Barry v Heider* (1914) 19 CLR 197 at 213-214; [1914] HCA 79; *Bahr v Nicolay [No 2]* (1988) 164 CLR 604 at 613, 637-639, 653-655; [1988] HCA 16.

24 *Cochrane v Cochrane* (1985) 3 NSWLR 403 at 404.

25 *Bofinger v Rekley Pty Ltd* [2007] NSWSC 1138.

26 *Bofinger v Kingsway Group Pty Ltd* (2008) 14 BPR 26,167.

The agreed facts

16 Something further now should be said respecting the agreed facts. These include attached documents and correspondence. There emerges what may be an incomplete account of events but it is upon this basis that the parties choose to present the question for separate determination.

17 Part 28 r 28.2 of the Uniform Civil Procedure Rules 2005 empowered the Supreme Court to make orders for the decision of any question before trial. In such a proceeding care is to be taken that agreed facts are stated with precision[27]. This is important, not the least because the parties to such a proceeding will be bound by the determination of the question and will not be at liberty subsequently in the same proceedings to advance argument or adduce further evidence directed to showing that the separate question was wrongly determined[28].

18 B & B Holdings carried on business as a real estate developer and on land ("the Enmore land") in an inner suburb of Sydney constructed 17 town houses and one house. It was placed in liquidation by February 2006 and the joint liquidators are the fourth respondent in this Court. They have entered a submitting appearance.

19 To finance the purchase of the Enmore land and the construction of the buildings thereon, in 2003 B & B Holdings borrowed $7,062,000 from the first mortgagee, Kingsway Group Limited. The interest rate initially was nine percent per annum. Then, as the project proceeded, B & B Holdings borrowed $1,400,000 from Rekley Pty Limited, the second mortgagee, and finally $350,000 from Mr John Edward Skehan, the third mortgagee. The indebtedness under these arrangements was secured in each case by registered mortgages against the title to the Enmore land and a property of B & B Holdings at Nullaburra Road, Caringbah. (There also appears to have been a fixed and floating charge in favour of the first mortgagee over the assets of B & B Holdings, but nothing turns upon this.)

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27 *Bass v Permanent Trustee Co Ltd* (1999) 198 CLR 334 at 357 [50]; [1999] HCA 9.

28 *O'Toole v Charles David Pty Ltd* (1991) 171 CLR 232 at 244-247, 260, 298; [1991] HCA 14.

20 The fifth, sixth and seventh respondents ("the Solicitors") carried on their practice at 575 Kingsway, Miranda under the name "Willis and Bowring Solicitors". They acted for the first mortgagee and for the second mortgagee and, at least in February 2006, for the third mortgagee as well. The first mortgagee is Kingsway Group Limited but throughout this period was named "Willis and Bowring Mortgage Investments Limited" and carried on business also at 575 Kingsway. The fifth respondent, one of the Solicitors, was a director of the first mortgagee. The eighth respondent was an officer of the first mortgagee. The third mortgagee, the third respondent, entered a submitting appearance in this Court.

21 In this Court, counsel for the Solicitors, for the first mortgagee and eighth respondent, and for the second mortgagee presented essentially a united front and divided the oral argument between them.

22 The first, second and third mortgages were dated respectively 31 January 2003, 14 March 2003 and 28 April 2005. In addition, by an instrument of guarantee dated 31 January 2003 (the date of the first mortgage) the appellants guaranteed to the first mortgagee repayment of the amount owing from time to time under the first mortgage by B & B Holdings. The guarantee was supported by mortgages by the guarantors to the first mortgagee over residential premises at Caringbah ("the Willarong Road property") and over a home unit in the same suburb ("the Bulwarra Street property"). Both properties were owned by the appellants. Thereafter, by instruments of guarantee dated respectively 14 March 2003 (the date of the second mortgage) and 28 April 2005 (the date of the third mortgage) the appellants guaranteed to the second and third mortgagees respectively repayment of the amounts from time to time owing to those parties by B & B Holdings. The guarantees given by the appellants to the second and third mortgagees also were secured by second and third mortgages over the Willarong Road property and the Bulwarra Street property. All three guarantees were relevantly in the same form.

23 The loan agreement between B & B Holdings and the first mortgagee had an expiry date of 1 February 2004. On 20 February 2004 the first mortgagee agreed to an increase in the loan amount to $8,288,000 with an increased interest rate and an extension to 1 October 2004. On 15 October 2004 it granted a further extension to 1 March 2005 and the loan amount was reduced to $8,278,000. On 23 March 2005, the first mortgagee agreed to a third extension to 1 October 2005, with a higher interest rate of 14.5 percent per annum; failure to pay the required interest amount by the 14th of each month would deprive the borrower of a lower interest rate of 9.5 percent and constitute an event of default.

24 Thereafter, on 28 April 2005, B & B Holdings entered into the loan agreement with the third mortgagee; this was secured by the third mortgage.

25 It is not clear when in this period B & B Holdings defaulted on the second mortgage. However, it defaulted on the first mortgage on 1 October 2005, and on the third mortgage on 28 October 2005.

26 In *China and South Sea Bank Ltd v Tan Soon Gin (alias George Tan)*[29] Lord Templeman observed that a surety, worried, for example, by the decline in value of securities held by the creditor from the principal debtor, may "bustle about", pay off the debt and take over the benefit of the securities.

27 In July 2005, that is to say during the currency of the third extension by the first mortgagee and after the apparent defaults which had occasioned the grant of the third extension, the appellants sold the Willarong Road property. From the proceeds they paid a total of $894,044.14 to the first mortgagee in reduction of the amount which was then owing to the first mortgagee by B & B Holdings and secured by the first mortgage. Thereafter, the appellants sold the Bulwarra Street property and on 5 October 2005 paid to the first mortgagee $625,190.26. This gave a total in payments to the first mortgagee by the appellants of $1,519,234.40.

28 It is important to note that following the sales of the Willarong Road property and the Bulwarra Street property there were discharges of the mortgages over those properties which the appellants had given not only to the first but also to the second and third mortgagees. Thereafter the guarantees given by the appellants remained in force but were unsecured. This may be important for the final working out of liabilities between the appellants and the second and third mortgagees, and may emphasise the importance to the appellants of their claim against the Solicitors. But, given the limited framework of the case to date, these matters were not pursued in argument.

29 There had been no call by the first mortgagee upon the guarantees, and in that sense the payments by the appellants were initiated by them. However, this was in the circumstances of default by B & B Holdings described above. The first mortgagee, necessarily involved so as to clear the titles, knew of the sales of the two properties by the appellants and also knew of the payment of the proceeds in reduction of the indebtedness of B & B Holdings.

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29 [1990] 1 AC 536 at 545.

30 In November 2005 the first mortgagee went into possession of the Enmore land. On or about 2 February 2006, the first mortgagee completed the exercise of its power of sale of Lot 13 of the Enmore land. By 8 February 2006 the indebtedness of B & B Holdings to the first mortgagee had been satisfied. However, its indebtedness to the second and third mortgagees was $1,935,671.23 and $464,267.12 respectively.

31 On 7 February 2006, the Solicitors wrote a letter directed to the attention of the eighth respondent, Mr Hatheier, an officer of the first mortgagee. The letter said, with reference to security over the Enmore land:

> "We advise that we act for the Second Mortgagee Rekley Pty Limited. This letter is to formally request possession of the 2 remaining unsold lots being lots 1 and 14 in the above development.
>
> Please pay the balance proceeds of sale in relation to lot 13 and the total proceeds of sale in relation to lot 5 to Willis & Bowring Trust Account."

On the next day, 8 February 2006, Mr Hatheier, describing himself as "Business Development Manager" of the first mortgagee, wrote to Willis and Bowring Solicitors, for the attention of Mr Tosolini, the fifth respondent:

> "We acknowledge receipt of your letter dated 7th February.
>
> We consent to your client Rekley Pty Limited taking possession.
>
> We now enclose the following:-
>
> 1. Keys
>
> 2. Deeds and Discharges of Mortgage in relation to lots 1 and 14
>
> We confirm that the balance proceeds of sale of lot 13 (after discharge of mortgage) and the proceeds of sale of lot 5 are to be paid to your trust account *for the purpose of being disbursed to your client*." (emphasis added)

The discharges of these first mortgages were subsequently registered on or about 8 February 2006.

32 On 20 February 2006, Mr Hatheier, on behalf of the first mortgagee, wrote to one of the liquidators of B & B Holdings. He enclosed copies of the letters of 7 and 8 February and wrote that the Solicitors were acting on behalf of the second and third mortgagees. This presumably was in addition to their acting for his company as first mortgagee. The letter indicated that $268,307.30 had been provided to the second mortgagee at settlement. It attached a summary of receipts and payments of the first mortgagee as mortgagee in possession. This showed payments to the first mortgagee of $3,848,000 and to the second mortgagee of $268,307 and, significantly, made an allowance for the earlier receipt from the appellants of the proceeds of sale of their properties. On 21 February 2006, the whole of the proceeds of sale of Lot 5, $432,712.53, was paid to the Solicitors on behalf of the second mortgagee.

33 The upshot was that by about 21 February or shortly thereafter the titles to Lots 1, 5, 13 and 14 of the Enmore land no longer showed the first mortgages by B & B Holdings and the second mortgagee had received surplus proceeds of sale of Lot 13 and the whole of the proceeds of Lot 5. Hence, as indicated in the opening passages of these reasons, the importance of the obligation to account to the appellants and of its nature and scope.

Statutory provisions

34 All the lands the subject of the various mortgages were lands under the provisions of the *Real Property Act* 1900 (NSW) ("the RP Act"), and the mortgages were registered mortgages. Section 57(1) of the RP Act provides that a mortgage has effect as a security but does not operate as a transfer of land. Section 58(1) provides for the exercise of a statutory power of sale. Section 58(2) protects the purchaser by denying any obligation to see to the application of the purchase money. Section 58(3) states that the purchase money from the sale of land by a mortgagee in exercise of power of sale "shall be applied", first in payment of the expenses of the sale, secondly in payment of the first mortgagee, thirdly in payment of subsequent mortgagees in order of priority and that any surplus is to be paid to the mortgagor. However, upon that first mortgagee equity may place requirements as to the disposition of the surplus purchase moneys.

35 *Adams v Bank of New South Wales*[30] is authority that s 58 is to be read in a manner consistent with the equitable duty of the first mortgagee to account to

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30 [1984] 1 NSWLR 285 at 299, 302.

puisne mortgagees as a trustee for any surplus. The position in equity was described as follows by Kay J in *Charles v Jones*[31] as follows:

> "I have never heard it doubted that where a mortgagee sells, and has a balance in his hands, he is a trustee of that balance for the persons beneficially interested. He takes his mortgage as a security for his debt, but, so soon as he has paid himself what is due, he has no right to be in possession of the estate, or of the balance of the purchase-money. He then holds them, to say the least, for the benefit of somebody else, of a second mortgagee, if there be one, or, if not, of the mortgagor. What, then, is he to do? *Surely he has a duty cast upon him. His duty is to say, 'I have paid my debt: this property which is pledged to me, and in respect of which I now hold this surplus in my hands, is not my property. I desire to get rid of this surplus, and hand it back to the person to whom it belongs.'* ... The duty of this mortgagee was at least to set this money apart in such a way as to be fruitful for the benefit of the persons beneficially entitled to it. *To that extent and in that manner he was, according to my understanding of the law, in a fiduciary relation to the persons entitled to the money*. It was so held in the case of *Quarrell v Beckford*[32], and so far as I know has always been so held, and although I quite agree that the Court is very reluctant to treat a mortgagee as being a trustee in any sense while any money is due to him, still when he has paid himself, and has money remaining in his hands which is no longer his property, how can he be treated as other than a trustee of such money?" (emphasis added)

36 The appellants sought to bring themselves, by reliance upon their subrogation rights, within the obligation of the first mortgagee to account to the person to whom the surplus belonged, and to place their rights in priority to any entitlement of the puisne mortgagees.

37 The appellants sought to support their case by reliance upon the provisions now made by s 3 of the *Law Reform (Miscellaneous Provisions) Act* 1965 (NSW) respecting the entitlement of sureties to assignment of securities. Section 3 is the

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31 (1887) 35 Ch D 544 at 549-550. See also *Banner v Berridge* (1881) 18 Ch D 254 at 269-270; *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 429-430; [1997] HCA 37; *Lloyds Bank NZA Ltd v National Safety Council* [1993] 2 VR 506 at 511, 514.

32 (1816) 1 Madd 269 [56 ER 100].

descendant in New South Wales of s 5 of the *Mercantile Law Amendment Act* 1856 (UK)[33]. The provisions confer upon sureties statutory rights and remedies which furnish a summary mode of carrying into effect those otherwise available in courts of equity[34]. The second mortgagee correctly submitted that if, as it contended, the appellants lacked an equity supporting subrogation, s 3 would not supply that deficiency.

The Supreme Court proceedings

38 By proceedings instituted in the Equity Division of the Supreme Court of New South Wales the appellants complained that in the circumstances they had an entitlement to recoupment of what they had paid as sureties and that this was in the nature of a trust binding the first mortgagee. They contended that in accounting to the second mortgagee in the manner described above, the first mortgagee had committed breaches of trust and that the second mortgagee had received trust property of the appellants. They sued the Solicitors as accountable under the principles associated with *Barnes v Addy*[35].

39 The separate question was:

> "In the circumstances of the case, were the sums of $268,307.33 and $432,712.53 and the securities over Lots 1 and 14 SP75069 held by the second defendant in trust for the plaintiffs as at 8 February 2006?"

40 The sense of the separate question was to ask whether, given that by 8 February 2006 the first mortgagee had been paid in full, it followed that in respect of surplus moneys attributable to the sale of Lots 5 and 13 of the Enmore land and the first mortgages over Lots 1 and 14, the first mortgagee was trustee for the appellants up to so much thereof as would give effect to their subrogation rights.

41 There was an immediate difficulty respecting any trust by the first mortgagee over the mortgages to it of Lots 1 and 14. The discharges were

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33 19 & 20 Vict c 97.

34 *Embling v McEwan* (1872) 3 VR (L) 52 at 53-54; *Hardy v Johnston* (1880) 6 VLR (L) 190 at 193.

35 (1874) LR 9 Ch App 244.

registered on or about 8 February and thus the subject matter of such a trust no longer existed.

42 In the event, the primary judge answered the separate question wholly in the negative. The primary judge thereafter entered judgment for the defendants in the suit. The Court of Appeal dismissed an appeal and made a special costs order in favour of the Solicitors. In this Court, the appellants seek to have those orders set aside and to have an affirmative answer to the question.

43 The appellants refer to the acceptance by Hodgson J that if a first mortgagee exercises its power of sale, the surety is entitled at least to a charge over the balance of the proceeds[36]. The respondents counter that even if there were such a charge it bound the subject matter only while it was in the hands of the first mortgagee. Further, the charge would confer no more than a security interest, would not entail fiduciary obligations owed by the chargor to the appellants, and would not support a proprietary interest which persisted against a third party such as the second mortgagee. Once the discharges of the first mortgages over Lots 1 and 14 reached the hands of the second mortgagee for registration, and the cash surplus reached its hands without the need for retention in an identifiable separate fund, any such charge would be spent[37]. (There may have been grounds in these circumstances for an action at law by the appellants against the second mortgagee for money had and received, but this was not considered in submissions to this Court[38].)

44 The preferred position of the appellants remained the trust in their favour. The respondents pointed to what were said to be the burdensome administration and investment duties this would entail[39].

The appropriate equitable remedy

45 It is unnecessary to resolve all of these questions. The essential task is to identify the scope of equitable relief which, in the circumstances of this case,

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36 *Russet Pty Ltd (In liq) v Bach* unreported, Supreme Court of New South Wales, Equity Division, 23 June 1988 at 12.

37 Cf *Lord Napier and Ettrick v Hunter* [1993] AC 713 at 738-739.

38 Cf *Lord Napier and Ettrick v Hunter* [1993] AC 713 at 752.

39 Cf *Lord Napier and Ettrick v Hunter* [1993] AC 713 at 738.

now adequately protects the position of the appellants that obtained on 8 February 2006, when the indebtedness of the first mortgagee had been satisfied.

46 Equitable intervention is sought by the appellants and this would have an impact upon the position of not just the first mortgagee but of the other respondents. Further, while there were proceeds of sale of Lots 5 and 13 it is not apparent from the agreed facts that they remain capable of separate identification and, in any event, the first mortgages over Lots 1 and 14 could not provide subject matter for any trust after registration of the discharges on or about 8 February 2006.

47 In this situation assistance is afforded by a point emphasised by four members of the Court in the joint reasons in *Giumelli v Giumelli*[40] when considering the constructive trust as a remedial response to a claim to equitable intervention. The point is that the term "constructive trust" may be used not with respect to the creation or recognition of a proprietary interest but to identify the imposition of a personal liability to account upon a defaulting fiduciary.

48 In *Jones v Southall & Bourke Pty Ltd*[41], after reviewing the authorities, Crennan J said that they:

> "make plain [that] the term 'constructive trust' covers both trusts arising by operation of law and remedial trusts. Furthermore, a constructive trust may give rise to either an equitable proprietary remedy based on tracing or, whether based on or independently of tracing, an equitable personal remedy to redress unconscionable conduct. The equitable personal remedies include equitable lien or charge or a liability to account."

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40 (1999) 196 CLR 101 at 111-112 [2]-[4] per Gleeson CJ, McHugh, Gummow and Callinan JJ; [1999] HCA 10.

41 (2004) 3 ABC (NS) 1 at 17. See also *Giumelli v Giumelli* (1999) 196 CLR 101 at 119-120 [31]-[32] and the form of the orders made at first instance by McLelland J in *United States Surgical Corporation v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766 at 820-822.

Earlier in her reasons her Honour had noted that the term "constructive trust" had been applied to include the enforcement of the obligation of a defaulting fiduciary to make restitution by a personal rather than a proprietary remedy[42].

49 The obligation to account, here by a first mortgagee, is consistent with what was said by Kay J in *Charles v Jones*[43] in the passage set out earlier in these reasons. On 8 February 2006 the first mortgagee was obliged in good conscience both to account to the appellants for surplus moneys and securities it held and not to undertake or perform any competing engagement in that respect without prior release by the appellants[44]. These obligations were fiduciary in character. As indicated by the correspondence of 7, 8 and 20 February 2006, to which reference has been made, the first mortgagee entered into and performed a conflicting engagement with the second mortgagee. The result was to cause loss to the appellants by denial of enjoyment of their entitlement to recoupment from the surplus moneys with respect to the sale of Lots 5 and 13 and first mortgages over Lots 1 and 14.

50 In respect of its misapplication of the surplus moneys and securities and the consequent loss to the appellants the first mortgagee is to be treated as a constructive trustee to the extent that it must account to the appellants as a defaulting fiduciary. It is unnecessary to seek to determine upon the agreed facts whether the first mortgagee was a trustee in a fuller sense which afforded the appellants a beneficial interest in the assets in question.

51 Breach by the first mortgagee of its above described fiduciary obligation to the appellants would suffice to engage the principles associated with the "second limb" in *Barnes v Addy*[45], if at any further hearing the necessary further

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42 (2004) 3 ABC (NS) 1 at 16.

43 (1887) 35 Ch D 544 at 549-550.

44 See *Pilmer v Duke Group Ltd (In liq)* (2001) 207 CLR 165 at 199 [78]; [2001] HCA 31; *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 393; *Bristol and West Building Society v Mothew* [1998] Ch 1 at 19; *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1 at 47; Finn, *Fiduciary Obligations*, (1977) at 253-254; Conaglen, "Fiduciary Regulation of Conflicts Between Duties", (2009) 125 *Law Quarterly Review* 111 at 119-122.

45 (1874) LR 9 Ch App 244. See *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 159-161 [159]-[165]; [2007] HCA 22.

facts are established against other respondents. In *Barnes v Addy* itself, the two solicitors, Messrs Preston and Duffield, had not received any trust property; the question was whether their knowledge made them accountable as parties to the breach of trust by the trustee and bound to make good as constructive trustees the loss of the trust assets.

The answer by the respondents' Notices of Contention

52 The respondents seek to outflank any conclusion such as that just expressed in several ways. A starting point is provided by *The Equity Trustees Executors & Agency Co Ltd v New Zealand Loan & Mercantile Agency Co Ltd*[46] where Lowe J said:

> "When a guaranteed debt is paid by the surety he is entitled, *unless the right is excluded by agreement or his conduct makes it inequitable to enforce it*, in respect of the amount he has paid under his guarantee to the securities which the creditor holds for the debt guaranteed. This right arises not from any agreement between the surety and the creditor, though it may be excluded by agreement between them. It rests on equitable principles." (emphasis added)

That statement of principle is plainly correct. The respondents, however, draw from the emphasised words two propositions of exception and rely upon them as an answer to any success the appellants' submissions otherwise might enjoy. First, the respondents say any right of the appellants was excluded by agreement, in particular by the terms of their guarantee of the second mortgage. Secondly, the respondents contend that this and other circumstances rendered it inequitable as between the appellants and the first mortgagee to rely upon *Drew v Lockett*[47]. Thirdly, it is said to follow that there is no footing to attach liability upon the first mortgagee to account to the appellants in respect of the surplus and so no basis for any remedy against other respondents.

The terms of the guarantee of 14 March 2003 to the second mortgagee

53 It is convenient to turn first to the terms of the appellants' guarantee given by deed on 14 March 2003 to the second mortgagee. The instrument is described

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46 [1940] VLR 201 at 205.

47 (1863) 32 Beav 499 [55 ER 196].

on the cover sheet as a "Deed of Guarantee and Indemnity". The settled principle in Australia governing the interpretation of contracts of guarantee and indemnity has been stated by this Court in authorities the most recent of which is found in the joint reasons in *Andar Transport Pty Ltd v Brambles Ltd*[48]. The principle is that a doubt as to the construction of a provision in such a contract should be resolved in favour of the surety or indemnifier. It is implicit in this that the doubt may arise not only from the uncertain meaning of a particular expression but from its apparent width of possible application.

54 Mr and Mrs Bofinger were each identified as "Guarantor", the second mortgagee as "Lender" and B & B Holdings as "Borrower". The "Mortgage" was the second mortgage by the Borrower, also dated 14 March 2003, and "Obligated Person" meant any of the Borrower, Guarantor, and any other person who was liable to the Lender for payment of the "Guaranteed Money", being the subject of the guarantee and indemnity in cl 3 and cl 5 respectively.

55 Clause 3 stated:

> "3.1 The Guarantors guarantee to the Lender:
>
> (1) the performance of all the obligations of the Borrower under the Mortgage; and
>
> (2) the payment of all damages suffered by the Lender (including interest costs and expenses) arising from any breach or termination of the Mortgage.
>
> 3.2 If the Borrower does not, on the date provided in the Mortgage, pay any amount payable to the Lender, the Guarantors must immediately pay that amount to the Lender."

56 Taken by itself cl 3 does not contain a covenant by the Guarantor to ensure that B & B Holdings meets its obligations to the second mortgagee in priority to those owed to the first mortgagee. Such a priority structure would have been at odds with the sequence of the registered mortgages and the circumstances of the borrowings to finance the development of the Enmore land. It would have required clear terms in a multi-party priority agreement.

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48 (2004) 217 CLR 424 at 433-437 [17]-[23]; [2004] HCA 28.

57 Clause 5 stated:

> "5.1 If the Borrower is not bound by some or all of the Borrower's obligations under the Mortgage, if for any other reason the guarantee is not effective, the Guarantors agree, by way of indemnity and principal obligation, to pay to the Lender the amount which would have been payable by the Guarantors to the Lender under the guarantee in clause 3 had the guarantee been effective and the Borrower been bound."

58 The lengthy provisions of cl 6 are headed "Matters Not Affecting Guarantor's Liability". Clause 6.4 is headed "Waiver by Guarantor" and its provisions were relied on in particular in submissions by the second mortgagee. The sub-clause reads:

> "Each Guarantor waives the Guarantor's rights as surety whether legal, equitable, statutory or otherwise which may be inconsistent with the provisions of this deed or in any way restrict the Lender's rights, remedies or recourse."

59 Counsel for the second mortgagee submitted that cl 6.4 extended to the waiver by the appellants of any surety rights they might have in respect of another instrument, namely the first mortgage. This was said to be the effect of the general words "the Guarantor's rights as surety". But the critical words which follow are "inconsistent with the provisions of this deed". They govern also the earlier words "Guarantor's rights as surety". The waiver effected by cl 6.4 is a waiver of such of the Guarantor's rights as surety under the guarantee to the second mortgagee as may be inconsistent with the provisions of the guarantee to the second mortgagee. It is not a waiver of any of the Guarantor's rights under the guarantee to the first mortgagee. This submission fails.

60 Counsel for the Solicitors sought to achieve a similar application to the first mortgage by reference to cl 3.1 and par (2) of cl 7.1. Clause 7.1 is headed "Guarantors Not To Claim Benefits Or Enforce Rights" and reads:

> "Until the Guaranteed Money is paid in full and all obligations of the Borrower under the Mortgage are fully and finally discharged or released, a Guarantor must not in any way:
>
> (1) claim the benefit or seek the transfer (in whole or in part) of any other guarantee, indemnity or security held or taken by the Lender;

(2) make a claim or enforce a right against any other Obligated Person or against the estate or any of the property of any of them (except for the benefit of the Lender); or

(3) raise or claim any set-off, counterclaim or defence available to any other Obligated Person in reduction of the Guarantor's liability under this deed."

61 Clause 7.1, as the opening words indicate, bars the Guarantor from taking any of the steps described in pars (1), (2) and (3) until two events have taken place. The first is the full payment of the moneys secured by the terms of the guarantee in cl 3; these are identified by reference only to the second mortgage by B & B Holdings. The second event is the discharge or release of all obligations of B & B Holdings under that mortgage. These events had not occurred at 8 February 2006, with the result that the restraints in pars (1), (2) and (3) were operative.

62 Paragraph (1) limits recourse to rights of the second mortgagee. Paragraph (3) is concerned with reduction of liability "under this deed". As the Solicitors accepted, neither paragraph constrains the exercise of rights under a guarantee of the first mortgage.

63 However, the Solicitors contended that par (2), read with cl 3.1 and the definition of "Obligated Person", manifested a particular intention by B & B Holdings, the appellants, and the second mortgagee. This was that the second mortgagee would "go first" in relation to the property of B & B Holdings and that the second mortgagee be protected from what otherwise might be prior claims by the appellants in reliance upon subrogation to the rights of the first mortgagee.

64 That submission also should be rejected. The Guarantor falls within the defined term "Obligated Person", as also does B & B Holdings. In asserting subrogation to the rights of the first mortgagee against B & B Holdings as Borrower, is the Guarantor making a claim against "any other Obligated Person" within the meaning of par (2)? The answer is suggested by the opening words of cl 7.1. These suspend engagement in this activity until full payment of the moneys guaranteed by cl 3, namely those secured by the second mortgage. Paragraph (1) then is directed to claims by the Guarantor to rights of the Lender (the second mortgagee), par (3) deals with claims to set-off and the like in reduction of the liability of the Guarantor to the Lender under the second mortgage, and par (2) with such matters relating to the guarantee of the second mortgage as claims by the Guarantor for indemnity for obligations under that guarantee by the Borrower or for contribution by any co-sureties.

65 If there be any doubt respecting the construction of cl 7.1 in this way, then, as indicated earlier in these reasons, the doubt is to be resolved in favour of the Guarantor.

66 It follows that in asserting rights of subrogation with respect to the first mortgage, the appellants were not acting in breach of any restrictions binding them by reason of the terms of the guarantee of the second mortgage. It follows further that there was nothing inequitable as between the appellants and the first mortgagee and the Solicitors (not parties to that guarantee) in the appellants seeking the support of equity in the manner described earlier in these reasons.

67 In particular, contrary to the submission by the Solicitors, the appellants were not bound to do equity by offering to perform an obligation to "protect" the second mortgagee as the price of any equitable relief founded on their subrogation rights in respect of the first mortgage. In *Langman v Handover*[49] Rich and Dixon JJ said that the maxim that he who seeks equity must do equity "does not substitute moral for legal standards in the determination of the conditions of relief". Rather, those who ask for the assistance of a court of equity must be willing to do justice by accepting terms which flow from the legal or equitable rights of the defendant to the suit.

68 The result is that the grounds in the Notices of Contention based upon the terms of the guarantee of the second mortgage fail.

69 The question for this Court then becomes whether the grounds of decision by the Court of Appeal should be sustained.

The reasoning of the Court of Appeal

70 The members of the Court of Appeal gave differing reasons for upholding the decision of the primary judge. Giles JA observed that it was important that the appellants had given guarantees not only to the first mortgagee but also to the second and third mortgagees. This distinguished the present case from *Drew v Lockett*[50]. As between the appellants and the second mortgagee the "plain intention" was that the second mortgagee was to have resort to its security after

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49 (1929) 43 CLR 334 at 351; [1929] HCA 42.

50 (1863) 32 Beav 499 [55 ER 196].

the first mortgagee but "prior to any entitlement [the appellants] might have with respect to that property". The appellants had undertaken obligations to the second mortgagee "inconsistent" with the assertion of prior entitlement to subrogation and "the priority which would otherwise arise" was displaced.

71 However, for the reasons already explained when dealing with the Notices of Contention, the terms of the guarantee given to the second mortgagee do not manifest any such intention. There was no displacement of priority between the mortgagees and the giving of the consecutive guarantees produced no inconsistency. Each guarantee operated in accordance with its terms. There was nothing in the circumstances rendering it inequitable for the appellants to enjoy the rights of subrogation.

72 Handley AJA relied upon an application or extension of the rule in *Otter v Lord Vaux*[51]. Of that rule, his Honour said that it:

> "prevents the mortgagor derogating from his grant and obtaining an advantage from his breach of contract. The mortgagee is estopped by his grant and contract from claiming priority over the second mortgage."

Handley AJA said that the estoppel was an estoppel by convention and added:

> "The position in the present case is substantially the same. The guarantors guaranteed each of the mortgages on the basis that one would be the first, another the second, and the other the third. The Principal Debtor could not have paid off the first and kept it alive for its own benefit. The guarantors, having guaranteed the second mortgage as a second mortgage, agreed in substance with the second mortgage[e] that once the first mortgagee was paid in full the second mortgagee would be paid next from one source or another before the guarantors got anything."

73 There are several obscurities in this passage. The reference in the second sentence to "each of the mortgages", when read with "[t]he Principal Debtor" in the next sentence, appears to be to the securities given by B & B Holdings not those given by the appellants in support of their guarantees. As things stood at 8 February 2006 there was no indebtedness remaining of B & B Holdings on its first mortgage and no occasion for B & B Holdings to pay it off and keep it alive for its benefit. Nor, as already indicated, was there any agreement, in substance

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51 (1856) 2 K & J 650 [69 ER 943].

or otherwise, between the appellants as guarantors and the second mortgagee that once the first mortgage had been paid in full (with the contribution made by the guarantors from the proceeds of sale of their two properties) the second mortgagee would be paid next and before the guarantors could recoup that contribution.

74 In *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd*[52] the Court said:

> "Estoppel by convention is a form of estoppel founded not on a representation of fact made by a representor and acted on by a representee to his detriment, but on the conduct of relations between the parties on the basis of an agreed or assumed state of facts, which both will be estopped from denying."

75 The reference to an agreed or assumed state of facts (not of law) is significant. In any event, in the present case the agreed facts fall far short of what would be necessary to establish that the priority of the second mortgagee which is now asserted was the conventional basis of the transaction between it and the appellants as guarantors, so that the appellants had been estopped from asserting their right of subrogation.

76 Nor does the rule in *Otter v Lord Vaux* depend upon reasoning which supplies any analogy for resolution of the present appeal. The rule is concerned with the merger of charges (including mortgages) in estates; the mortgages by B & B Holdings were of land under the provisions of the RP Act and thus were "creatures of statute" to which the general law principles of destruction by merger did not apply[53].

77 The rule of the common law is that whenever a greater and a lesser estate meet in the same person, without any intermediate estate, the lesser is sunk or drowned in the greater. Accordingly, at common law, where a person entitled to land acquires a security over it, a merger is conclusively presumed; the security merges and disappears in the greater estate. However, equity gives effect to an

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52 (1986) 160 CLR 226 at 244; [1986] HCA 14.

53 *English Scottish and Australian Bank Ltd v Phillips* (1937) 57 CLR 302 at 322-323; [1937] HCA 6.

intention of the parties that there be no merger[54]. But to that acceptance of intention as controlling the outcome there is an exception. This is identified as the rule in *Otter v Lord Vaux*. A mortgagor who has paid off an encumbrance thereafter cannot set it up in priority to a puisne mortgage which the mortgagor has granted. Why is this so? The answer, which has the support of Viscount Haldane LC[55] and Megarry J[56], is as follows[57]:

> "a second mortgage, as between the parties, is a grant of the mortgagor's entire interest in the property, saving only the rights of the prior incumbrancer, and the mortgagor cannot derogate from his grant by holding the first mortgage against the second mortgagee".

The rule in *Otter v Lord Vaux* has been applied to securities over personal property[58]. But as indicated above, there was no question in the present case of any merger by operation of law, with a contrary intention to which equity would not give effect.

78 The preferred basis upon which Sackville AJA decided the appeal was that the conduct of the first mortgagee in accounting to the second mortgagee for the surplus proceeds was not "unconscionable". His Honour answered in the negative the question he posed as follows:

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54 *Commissioner of Stamp Duties (NSW) v Perpetual Trustee Co Ltd* (1915) 21 CLR 69 at 87; [1915] HCA 91; *Lewis v Keene* (1936) 36 SR (NSW) 493 at 499. In New South Wales, s 10 of the *Conveyancing Act* 1919 (NSW) enacts that there shall be no "merger by operation of law only of any estate, the beneficial interest in which would not be deemed to be merged or extinguished in equity".

55 *Whiteley v Delaney* [1914] AC 132 at 144-145.

56 *Brunner v Greenslade* [1971] Ch 993 at 1002.

57 Waldock, *The Law of Mortgages*, 2nd ed (1950) at 437, quoted in *Sussman v AGC Advances Ltd* (1995) 37 NSWLR 37 at 51.

58 *In re W Tasker & Sons Ltd* [1905] 2 Ch 587 at 599-600, 603, where the property was corporate debentures. The law was altered retrospectively by s 15 of the *Companies Act* 1907 (UK): *In re New London and Suburban Omnibus Company* [1908] 1 Ch 621 at 625-626; *White and Tudor's Leading Cases In Equity*, 9th ed (1928), vol 2 at 34-35.

> "But in what way is the doctrine of subrogation needed to avoid an unconscionable result? Or, to put the question another way, what would be unjust or inequitable about the net surplus from the sale of the Principal Debtor's assets going to the second mortgagee, as envisaged by s 58(3) of the [RP Act] ...?"

79 The answer is that for the reasons already given the first mortgagee was required by equity to account for the net surplus to the appellants. That obligation was imposed upon the enjoyment by the second mortgagee of its entitlement under s 58(3) of the RP Act.

80 His Honour also said:

> "The arrangements were plainly not intended to allow the appellants, by paying out the first mortgagee, to transform the second mortgagee from a secured creditor of [B & B Holdings] to an unsecured creditor presumably ranking equally with the other unsecured creditors of the appellants."

There are difficulties with this passage. On the agreed facts the appellants had been able to sell their two properties and so raise the moneys paid by them in reduction of the indebtedness of B & B Holdings to the first mortgagee only because the three mortgagees had consented to the clearing of the title to those two properties. The second and third mortgagees had not, for example, protected their position by obtaining an agreement with the appellants and the first mortgagee expressly to deny to the appellants what otherwise would be their subrogation rights to the first mortgage over the assets of B & B Holdings.

81 Sackville AJA referred to the passage in *Tanwar Enterprises Pty Ltd v Cauchi*[59] where, after noting that the terms "unconscientious" and "unconscionable" are used across a broad range of equity jurisdiction, Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ continued:

> "They describe in their various applications the formation and instruction of conscience by reference to well developed principles. Thus, it may be said that breaches of trust and abuses of fiduciary position manifest unconscientious conduct; but whether a particular case amounts to a breach of trust or abuse of fiduciary duty is determined by reference to well developed principles, both specific and flexible in character. It is to

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59 (2003) 217 CLR 315 at 324 [20]; [2003] HCA 57.

those principles that the court has first regard rather than entering into the case at that higher level of abstraction involved in notions of unconscientious conduct in some loose sense where all principles are at large."

82 However, Sackville AJA appears to have proceeded, not in accordance with that passage, particularly its last sentence, but by asking whether and in what way the doctrine of subrogation was "needed to avoid an unconscionable result" and answering that there was nothing unconscionable or unjust in the first mortgagee applying the surplus proceeds of sale to the second mortgage. But this reasoning does not allow for the circumstance that the surplus was computed only after allowance for the payments which had been made by the appellants to reduce the secured indebtedness of B & B Holdings. These payments had enlivened the doctrine of subrogation, subject to the operation of which, and subject to contrary agreement or inequitable conduct, the parties were to be taken to have conducted their affairs.

83 Sackville AJA referred to the judgment of Kearney J in *Cochrane v Cochrane*[60]. This is often, and correctly, cited as containing an orthodox statement and application of principles respecting the interrelation between the doctrines of subrogation and contribution. The remedy of one co-mortgagor who pays off the mortgage in full is not of subrogation to the rights of the mortgagee against the other mortgagor, but to contribution from that mortgagor.

84 Kearney J also referred to the implied indemnity by the principal debtor which reflected the ultimate liability of that party in cases of suretyship[61]. It was that ultimate liability of B & B Holdings which in the present case founded the application of the doctrine of subrogation in favour of the appellants. Kearney J contrasted the right of subrogation with the right of contribution between those, such as the present appellants, who are subject to co-ordinate liabilities or common obligations. There equity is moved by concern that the common exposure of the contributors to the creditor and the equality of burden not be defeated by the accident or chance that the creditor select for recovery one or some rather than all of the contributors[62].

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60 (1985) 3 NSWLR 403.

61 (1985) 3 NSWLR 403 at 405.

62 *Friend v Brooker* (2009) 83 ALJR 724 at 732 [38]; 255 ALR 601 at 609-610.

Unjust enrichment and the English decisions

85 The appeal to this Court in *Friend v Brooker*[63], which concerned the equitable doctrine of contribution, was correctly conducted on the footing that the concept of unjust enrichment was not a principle supplying a sufficient premise for direct application in a particular case. The same is true of the equitable doctrine of subrogation. The oral submissions for the Solicitors correctly recognised this.

86 In a passage in their reasons in *David Securities Pty Ltd v Commonwealth Bank of Australia*[64], Mason CJ, Deane, Toohey, Gaudron and McHugh JJ rejected the submissions that in Australian law unjust enrichment was more than "just a concept" and that it was "a definitive legal principle according to its own terms". The use of the phrase "unifying legal concept" earlier in the joint reasons[65] must be understood with what was said in that later passage[66]. In the years which have followed the Court has reaffirmed this position[67] and all other Australian courts are bound accordingly.

87 A not dissimilar fate met the attempt to adopt "proximity" as the "unifying theme" of the categories of case recognising a duty to take reasonable care to avoid a reasonably foreseeable risk of injury to another[68].

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63 (2009) 83 ALJR 724 at 728 [7]-[8]; 255 ALR 601 at 604.

64 (1992) 175 CLR 353 at 378-379; [1992] HCA 48.

65 (1992) 175 CLR 353 at 375.

66 Cf *Ford (by his tutor Watkinson) v Perpetual Trustees Victoria Ltd* (2009) 257 ALR 658 at 684.

67 *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 156 [151] per Gleeson CJ, Gummow, Callinan, Heydon and Crennan JJ; *Lumbers v W Cook Builders Pty Ltd (In liq)* (2008) 232 CLR 635 at 664-665 [83]-[85] per Gummow, Hayne, Crennan and Kiefel JJ; [2008] HCA 27.

68 See *Bryan v Maloney* (1995) 182 CLR 609 at 619; [1995] HCA 17, and the later decisions collected in *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 at 528-529 [18]; [2004] HCA 16.

88 The concept of unjust enrichment may provide a means for comparing and contrasting various categories of liability. Reference has been made to *Cochrane v Cochrane*[69] and this provides an example. Subrogation may be seen as preventing the unjust enrichment of the principal debtor who otherwise might escape carriage of ultimate liability and contribution prevents one of equal obligors bearing more than its share of the burden. The two doctrines do not let matters lie where they would fall if the carriage of risk between the various actors involved were to be left entirely to be worked out within the limits of their contractual obligations. But as *Cochrane* shows, and as explained above, the two doctrines have different foundations in equity and operate with different results.

89 The concept of unjust enrichment also may assist in the determination by the ordinary processes of legal reasoning of the recognition of obligations in a new or developing category of case[70]. An example is the conclusion reached in *David Securities* itself, that the vitiating factors which enliven the action for money had and received include mistakes of fact or law. But this appeal is not in that category. The principles of equity which govern the outcome are well developed and have the vitality to permit further development in an orthodox fashion.

90 Subrogation, like other equitable doctrines, is applicable to a variety of circumstances, as explained earlier in these reasons. One circumstance concerns sureties, another the paying off of an existing mortgage. But that is not to say that subrogation is a "tangled web"[71] in need of the imposition of the "top-down" reasoning which is a characteristic of some all-embracing theories of unjust enrichment[72].

91 Such all-embracing theories may conflict in a fundamental way with well-settled equitable doctrines and remedies. Reference was made in the opening paragraph of these reasons to the importance attached by equity to the

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69 (1985) 3 NSWLR 403.

70 *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221 at 257; [1987] HCA 5; *Lumbers v W Cook Builders Pty Ltd (In liq)* (2008) 232 CLR 635 at 665 [85].

71 See Goff and Jones, *The Law of Restitution*, 4th ed (1993) at 592. This statement was removed from subsequent editions.

72 See *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 156 [151].

fashioning of the particular remedy to meet the nature of the case. The administration of the remedies of injunction and specific performance provides perhaps the most obvious examples. So also the remedial constructive trust, as these reasons have sought to demonstrate.

92 Equity has been said to lack the necessary "exacting taxonomic mentality" when providing an appropriate remedy for unconscientious activity[73]. The better view is said to be that liability in "unjust enrichment" is strict, subject to particular defences[74], while "[t]he unreliability of conscience" offends the precept that like cases must be decided alike and not by "a private and intuitive evaluation"[75].

93 But the experience of the law does not suggest debilitation by absence of a sufficiently rigid taxonomy in the application of equitable doctrines and remedies. And legislatures have taken the same view in Australia, notably by calling upon equitable analogues in framing the remedial provisions laid out in Pt VI of the *Trade Practices Act* 1974 (Cth).

94 As these reasons have sought to show, the relevant principles of equity do not operate at large and in an idiosyncratic fashion. So it was that in *Boscawen v Bajwa*[76], Millett LJ, after denying that subrogation is a remedy which the court has a general discretion to impose whenever it thinks fit to do so, went on:

> "The equity arises from the conduct of the parties on well settled principles and in defined circumstances which make it unconscionable for the defendant to deny the proprietary interest claimed by the plaintiff."

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73 Birks, "Equity in the Modern Law: An Exercise in Taxonomy", (1996) 26 *University of Western Australia Law Review* 1 at 16-17.

74 Birks, "Equity in the Modern Law: An Exercise in Taxonomy", (1996) 26 *University of Western Australia Law Review* 1 at 67-68.

75 Birks, "Equity in the Modern Law: An Exercise in Taxonomy", (1996) 26 *University of Western Australia Law Review* 1 at 17.

76 [1996] 1 WLR 328 at 335; [1995] 4 All ER 769 at 777.

95 That was said in 1995. In England matters appear now to stand differently[77].

96 *Banque Financière de la Cité v Parc (Battersea) Ltd*[78] concerned the application or extension of the reasoning in the authorities[79] allowing subrogation of a third party to securities paid off by that party. Counsel for the successful appellants had submitted no more than that, while there is "an inevitable link" between unjust enrichment and subrogation, "the two are not co-extensive"[80]. It may well be that the result in that case could have been arrived at by development of orthodox equitable principles of subrogation[81]. However, Lord Hoffmann, who gave the most detailed opinion, referred[82] to the use of the term "subrogation":

> "to describe an equitable remedy to reverse or prevent unjust enrichment which is not based upon any agreement or common intention of the party enriched and the party deprived".

His Lordship then considered various cases in which securities were "kept alive" on the footing that a third party who paid off the security was presumed in equity to intend that it be so retained for the benefit of that party[83]. Lord Hoffmann concluded[84]:

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77 The English authorities, of which the most recent was *Cheltenham & Gloucester plc v Appleyard* [2004] EWCA Civ 291, were analysed by Mr Tilley in his article "Restitution and the law of subrogation in England and Australia", (2005) 79 *Australian Law Journal* 518.

78 [1999] 1 AC 221.

79 Notably, *Ghana Commercial Bank v Chandiram* [1960] AC 732.

80 [1999] 1 AC 221 at 223.

81 See the note by Jackman, "Restitution and subrogation", (1999) 73 *Australian Law Journal* 110 at 112.

82 [1999] 1 AC 221 at 231.

83 [1999] 1 AC 221 at 232-233.

84 [1999] 1 AC 221 at 234.

> "I think it should be recognised that one is here concerned with a restitutionary remedy and that the appropriate questions are therefore, first, whether the defendant would be enriched at the plaintiff's expense; secondly, whether such enrichment would be unjust; and thirdly, whether there are nevertheless reasons of policy for denying a remedy."

97 However, there is difficulty in identifying the "unjust" enrichment in subrogation cases, which necessarily involve multilateral, rather than bilateral, relationships[85]. Further, as Bryson J later explained, the reasoning of Lord Hoffmann in *Banque Financière* does not[86]:

> "provide an explanation for the mortgagor's being treated as bound, in equity, to treat the person who paid off the previous mortgage as entitled to security under it. Restitution would provide a basis for treating the mortgagor as obliged to restore to the person who paid it the amount which had been paid to the mortgagee: the concept is inadequate for also treating the mortgagor as obliged to hold the payer secured. This is particularly clear where, as in this case, and in other cases where subrogation has been held to exist, the mortgagor in fact had no dealings with the payer, or where the payer believed that he was getting security under arrangements in which the mortgagor was not in fact involved."

98 In the present case, Giles JA described the understanding in Australia of the doctrinal basis of subrogation as "open to debate" by reason of the recent English authorities. However, for the above reasons, and contrary to the earlier suggestion in *Highland v Exception Holdings Pty Ltd (In liq)*[87], the doctrinal basis of equitable subrogation in Australian law is not unsettled. The respondents, led by counsel for the Solicitors, in this Court correctly eschewed any attempt to support the outcome in the Court of Appeal by application of reasoning in the recent English cases.

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85 See Goff and Jones, *The Law of Restitution*, 7th ed (2007) at 132, where the learned authors write that by reason of the tripartite relationship of the parties "it is not always easy to determine whether it is B or C who has been enriched and why a court should conclude that the enrichment is an unjust enrichment".

86 *Challenger Managed Investments Ltd v Direct Money Corporation Pty Ltd* (2003) 12 BPR 22,257 at 22,269.

87 (2006) 60 ACSR 223 at 239.

Orders

99 The appeal should be allowed. Order 1 of the orders of the Court of Appeal entered 29 December 2008 and the further orders entered 8 July 2009 should be set aside. In their place, it should be ordered that: (a) the appeal to the Court of Appeal be allowed; (b) orders 1 and 2 of the orders made by the primary judge and entered on 18 February 2008 should be set aside; (c) the separate question stated on 16 November 2006 should be answered as follows:

> "In the absence of prior consent or release by Mr and Mrs Bofinger, on 8 February 2006 Kingsway Group Limited was obliged to account to Mr and Mrs Bofinger as a constructive trustee for any dealing by it with the moneys and securities identified in the question for decision in favour of any other party, and to pay equitable compensation to Mr and Mrs Bofinger in respect of the denial or limitation by such dealing of recoupment from those moneys and securities of moneys paid by Mr and Mrs Bofinger to Kingsway Group Limited, in total $1,519,234.40, from the proceeds of sale of their properties at 407 Willarong Road, Caringbah and 2/41 Bulwarra Street, Caringbah."

The third and fourth respondents entered submitting appearances in this Court. The costs of the appellants in this Court, in the Court of Appeal and of the proceedings to date in the Equity Division of the Supreme Court, should be paid by the first, second, fifth, sixth, seventh and eighth respondents.

100 It will be for the appellants to take such steps as may be appropriate to restore the proceedings in the Equity Division for consideration of remaining issues. These will include the rate and nature of an interest component of the sum for which there is to be equitable compensation to the appellants[88].

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88 See *Hermann v Charny* [1976] 1 NSWLR 261 at 270; and the authorities collected in *Victorian Workcover Authority v Esso Australia Ltd* (2001) 207 CLR 520 at 531-532 [24]; [2001] HCA 53.