SUPREME COURT OF QUEENSLAND

CITATION:	*Clout & Ors v. Klein & Ors* [2003] QSC 152
PARTIES:	**DAVID LEWIS CLOUT** AND **LACHLAN STUART McINTOSH** (first plaintiffs) AND **FIBRE TEK (GOLD COAST) PTY LTD (RECEIVERS & MANAGERS APPOINTED) (IN LIQUIDATION) ACN 010 811 980** (second plaintiff) **v** **GARY MONTAGUE KLEIN** (first defendant) AND **PETER JAMES HILBERT** (second defendant) AND **BERNARD JOHN HILBERT** (third defendant) AND **VON INVESTMENTS PTY LTD ACN 000 899 570** (fifth defendant)
FILE NO:	10717 of 2000
DIVISION:	Trial Division
PROCEEDING:	Application
ORIGINATING COURT:	Supreme Court Brisbane
DELIVERED ON:	12 May 2003
DELIVERED AT:	Brisbane
HEARING DATE:	21 March 2003
JUDGE:	Holmes J
ORDER:	**That upon the first plaintiff Lachlan Stuart McIntosh, the second plaintiff and Stephen Charles Russell offering the usual undertaking as to damages:** **1. the first defendant by himself, his servants, his agents or otherwise be restrained from dealing with registered mortgage No 701647811 over lot 287 on registered plan No 210984 until the trial of the proceeding**

or further earlier order.

2. **the first defendant deliver any release of registered mortgage No 701647811 which is in or comes into his possession to the custody of the registrar of this honourable court to be held pending the trial of the proceeding or until further order.**

CATCHWORDS: GUARANTEE AND INDEMNITY – DISCHARGE OF SURETY – ALTERATION OF OBLIGATION GENERALLY – where receivers made payment to bank – where dispute as to the nature of the payment – where part payment of debt – whether entitlement to subrogate arises from part payment

EQUITY – EQUITABLE REMEDIES – INJUNCTIONS – INTERLOCUTORY INJUNCTIONS – JURISDICTION AND GENERALLY – whether serious question to be tried as to the nature of payment – whether balance of convenience favours granting of injunction

Mercantile Act 1867 (Qld)

Scholefield Goodman & Sons Ltd v Zyngier [1984] VR 445.
Re Davison's Estate (1893) 31 Lr Ir 249.
Yonge v Reynell (1852) 68 ER 744 at 748, per Turner VC.
Craythorne v Swinburne (1807) 33 ER 482 at 485.
Banque Financiere de la Cite v Parc (Battersea) Ltd [1999] 1 AC 221.
Equity Trustees Executors & Agency Co Ltd v New Zealand Loan & Mercantile Agency Co. Ltd [1940] VLR 201.
A E Goodwin Ltd v A G Healing Ltd (1979) 7 ACLR 481.
McColl's Wholesale Pty Ltd v State Bank of New South Wales [1984] 3 NSWLR 365.
Russet Pty Ltd (in liq) v Bach (unrep) of Supreme Court of New South Wales in No 2 Act 56 of 1985 23 June 1988.
Bayley & Anor v Gibsons Ltd & Ors (1993) 1 Tas R 385.
Omlaw Pty Ltd v Delahunty [1995] 2 Qd R 389.

COUNSEL: Mr Cowen for the plaintiffs

Mr Cooper for the first defendant

SOLICITORS: Tucker & Cowen for the plaintiffs

Lyon Smith Commercial Lawyers for the defendant

[2] The plaintiffs' application as framed seeks an interlocutory injunction restraining the first defendant from dealing with mortgages or securities held by the National Australia Bank Ltd ("the Bank") in respect of loans or other forms of financial accommodation made in respect of land at 32-36 Industrial Avenue, Molendinar. On the hearing of it, it emerged that they are really concerned to prevent the release

of a mortgage held by the Bank over a house property at Runaway Bay owned by the first defendant and his wife.

The plaintiffs' claims

[3] The first plaintiffs are the liquidators of the second plaintiff. It conducted a business of swimming pool manufacture and sale on the land at Molendinar, which its former directors, the first, second and third defendants, held under a special lease. In their further amended statement of claim the plaintiffs plead that in 1998 the first and third defendants borrowed $660,000 from the Bank to convert the leasehold interest in the Molendinar land into freehold. In order to obtain the loan, they caused the second plaintiff to execute a guarantee and indemnity in favour of the Bank. The Bank already held a fixed and floating charge over the second plaintiff's assets, which now secured, in addition, its obligations under the guarantee. The first defendant and his wife, Margaret Klein, also executed the guarantee. The latter's liability under the guarantee was limited to the extent of her interest in their joint property at 19 Midnight Court, Runaway Bay, over which the Bank also held a mortgage which secured, *inter alia*, the freeholding loan.

[4] In June 1999 the Bank demanded the sum of $708,931.20 then owing under the loan from the first and third defendants and, pursuant to the guarantee, from the second plaintiff. The moneys owed were not paid. In July 2000 the Bank, pursuant to the charge it held, appointed a receiver and manager to the second plaintiff. The receiver, having realized the second plaintiff's assets in an amount of $613,636.16, paid $250,000 to the Bank and applied the balance in various ways, including, according to the statement of claim, expending $279,785.36 on "receiver's remuneration and expenses" and "expenses and liabilities incurred in receivership". The balance of the freeholding loan was paid out from the sale of the Molendinar land. An amount of $776,442.94 representing the proceeds of the land sale less what was owed to the Bank, was paid into court in December 2000 pursuant to an order of Mullins J, who also restrained the bank from dealing with any of its securities in respect of the relevant debt without first giving 14 days notice to the parties.

[5] The relief claimed by the plaintiffs includes, as against the first, second and third defendants, orders for payment by them of expenditures totalling $1,764,565 which, it is alleged, they caused, in breach of their duties, to be made by the second plaintiff; and, as against the first and third defendants, payment of $570,052.12 representing the receiver's outgoings, which are characterised as the second plaintiff's meeting of its obligations under the guarantee. The second plaintiff also claims a declaration that, the moneys secured under the mortgage of the Molendinar land having been paid, it "will, on payment of all sums secured under the Fourth Defendants mortgage of land at 19 Midnight Court, Runaway Bay owned by the first defendant and Margaret Gibb Klein ('the Runaway Bay mortgage'), be entitled, by s 4 of the *Mercantile Act* 1867, to a transfer of that mortgage".

Serious question to be tried

[6] Mr Cowen, for the plaintiffs, put the position thus: the Bank had appointed a receiver to the second plaintiff in circumstances in which the company's indebtedness to the Bank, apart from the obligations under the guarantee, amounted to some $2,500. It was clear, he said, that the appointment of receivers was in respect of the liability under the guarantee. The receivers had realized some $600,000 worth of assets and had paid the Bank about $250,000. The payment under the guarantee gave rise to an entitlement to recovery from the first defendant as a principal debtor, and, more importantly for present purposes, a right of subrogation to the Bank's securities, which included its mortgage over the first defendant's property at Runaway Bay. That entitlement to subrogate would come into being as soon as all debt to the Bank secured by the mortgage was satisfied. The first defendant had intimated an intention to pay the balance owing and redeem the mortgage.

Whether the surety made a payment under the guarantee

[7] At issue between the parties was whether the amount of $250,000, or any part of it, had in fact had been paid in discharge of the liability in respect of the freeholding loan.

[8] A letter from the Bank's solicitors dated 25 May 2001 gives the following accounting:

> "That amount has been applied as follows:-
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> | | |
> |---|---|
> | Balance debt on overdraft account no 517525539 | $ 1,575.09 |
> | Balance chattel lease debt | $ 1,065.16 |
> | Payment of rent for Molendinar land | $135,000.00 |
> | Legal costs etc re enforcement of security | $ 53,138.09 |
> | Other realisation/enforcement items | $ 18,277.80 |
> | Amount retained | $ 40,943.86" |

[9] Mr Cooper, for the first defendant, submitted that the amounts for "balance debt on overdraft account" and "balance chattel lease debt" were clearly attributable solely to the second plaintiff's indebtedness to the Bank, and this was not in dispute. But the characterisation of the component of $135,000 as rent for the Molendinar land is the subject of dispute. Mr Cooper argued that the Bank received this sum as rent in its capacity as mortgagee in possession liable to account to the tenants in common. It was not paid in reduction of a debt.

[10] As early as January 2000 the solicitors for the second plaintiff challenged the Bank's claim to rent, asserting that there was no agreement for it. They indicated, however, that the second plaintiff was prepared to pay $3,000 per week as rent, while reserving its right to contend that the payments were made in reduction of the principal debt. The Bank seems to have accepted this, and in a letter of 19 July 2001 recorded the figure of $135,000 as "amount due and owing for rent (accounted for in reduction of debt of Messrs. Klein & B Hilbert)". That letter also breaks down further the items shown as "other realisation/enforcement items": it

consists of two sets of investigation fees paid to KPMG in respect of amounts of $12,552.80 and $5,425.

[11] Mr Cooper asserted that the enforcement fees related to the enforcement of the Bank's charge over the second plaintiff's undertaking and assets, rather than the freeholding loan. But Mr Cowen pointed out that the first plaintiff's liability under the guarantee included the costs of enforcement by the Bank of any remedy under the guarantee or any other security; so that this amount was, in fact, part of the principal debt. In addition, further amounts totalling $322,692.37 had been expended in the course of the receivership, in circumstances where the receivers would not have been appointed but for the principal debtor's default under the freeholding loan.

[12] For present purposes, it seems to me appropriate to proceed on the basis that the enforcement costs were paid in reduction of the principal debt and that there is at least a serious question as to whether the amounts characterised as rent were in fact again a reduction of the principal debt.

Whether the surety is entitled to subrogate for part payment

[13] The plaintiffs relied on an equitable right of subrogation, given statutory effect by s 4(1) of the *Mercantile Act* 1867. That sub-section provides that:-

> "**4.(1)** Every person who being surety for the debt or duty of another or being liable with another for any debt or duty shall pay such debt or perform such duty shall be entitled to have assigned to the person or to a trustee for the person every judgment speciality or other security which shall be held by the creditor in respect of such debt or duty whether such judgment speciality or other security shall or shall not be deemed at law to have been satisfied by the payment of the debt or performance of the duty."

Mr Cowen contended that if the second plaintiff had paid any amount in reduction of the principal debt, it was entitled to subrogate at least to the extent of that payment. Pending payment in full of all debts secured by the mortgage it had at least what is described in *Omlaw Pty Ltd v Delahunty*[1] as a contingent entitlement to assignment of any securities, a right capable of declaration and protection by restraining order[2].

[14] Mr Cooper argued that payment of part only of the debt could not enliven s 4, which referred to "payment of the debt", not to part payment. It was essential to subrogation that the paying surety have an intention to assume the security upon the payment of the debt. A surety merely reducing rather than discharging the debt

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1 [1995] 2 Qd R 389.

2 *Challenge Bank Ltd v Mailman* (unreported, NSW CA 40238 of 1992, 14 May 1993); *Dixon v Steel* [1901] 2 Ch 602 at 607.

could not have had an intention at the time of payment to have the security assigned to it. He cited *Scholefield Goodman & Sons Ltd v Zyngier*[3] for these propositions.

[15] I do not think that *Scholefield Goodman & Sons Ltd v Zyngier* assists on the point. In that case the respondent had executed a mortgage by which she covenanted to pay a bank the amount owed by the debtor on current account with it as well as other sums for which the debtor was liable in respect of bills of exchange held by the bank. Shortly after, the appellant drew five bills of exchange accepted by the debtor and payable to the order of the bank, which were dishonoured by the debtor on presentation and were ultimately met by the appellant. Meanwhile, on the debtor's default, the bank made demand on the respondent for the secured monies, which the respondent paid; she then sought a discharge of the mortgage. The appellant claimed that it was entitled to contribution from the respondent in respect of the payments it had made and to an assignment of the mortgage. The court rejected that claim on the grounds that the two parties were not liable for the same debt. The respondent would not be entitled to contribution until she had paid the whole of the balance of account, and she could not have been required by the bank to pay separately the amount of the bills, the debt for which the appellant was liable. There was no mutual right of contribution between the appellant and the respondent. *Scholefield Goodman & Zyngier* is to be distinguished from the circumstances of the present case, in which the first defendant as principal debtor and the second plaintiff as guarantor were liable for the same debt, in respect of which the bank could and did make demand on both of them.

[16] I doubt that the notion of an intention to keep the security alive has any application to the circumstance of a surety paying under compulsion, as opposed, for example, to that of a third party advancing funds to pay off a prior security. Dr Craig Rotherham in a chapter contributed to *The Law Of Restitution*[4] gives this perspective:

> "In addition, it is sometimes said that the surety is presumed to keep the security alive for his own benefit[5]. However, the presumption is plainly counterfactual. It has been recognised that the surety 'seldom if ever stipulates for the benefit of the security which the principal debtor has given'[6]. Moreover, as mentioned, sureties are entitled to enforce both securities of which they were unaware at the time they entered into the guarantee and securities that were given after the guarantee was made[7]. Thus, these rights are better understood as being conferred by operation of law."

[17] And the importance of intention in relation to subrogation at large must be doubted in the light of an emerging tendency to regard subrogation as a restitutionary remedy designed to prevent unjust enrichment:

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3 [1984] VR 445.

4 Ed Grubb Hedley & Halliwell, Butterworths 2002 at p 142.

5 *Re Davison's Estate* (1893) 31 Lr Ir 249 at 255, affirmed at [1894] 1 IR 56; Goff and Jones *Law of Restitution* (5th edn. 1998), p 134.

6 *Yonge v Reynell* (1852) 68 ER 744 at 748, per Turner VC.

7 *Craythorne v Swinburne* (1807) 33 ER 482 at 485.

> "It is a mistake to regard the availability of subrogation as a remedy to prevent unjust enrichment as turning entirely upon the question of intention, whether common or unilateral".[8]

[18] It is clear that a surety has no right to be subrogated to the creditor's securities until the latter has been paid the full amount of the debts which they secure[9], so that in the present case, the second plaintiff has no entitlement to assignment of the mortgage until the first defendant's indebtedness under it has been entirely discharged. But while the debt the subject of the guarantee must be paid in full before subrogation is available, there is a considerable body of authority to the effect that it need not be met in its entirety by the surety.[10] That may be so whether statutory or equitable rights be relied on.[11] And there seems no warrant for the proposition advanced by Mr Cooper, that only the party finally discharging the debt acquires the right to subrogate. That would lend itself to capricious results of the very kind which equity seeks to prevent by permitting subrogation.[12]

[19] My view is that there is a serious question to be tried as to the plaintiffs' right of recovery against the principal debtors and their entitlement to assignment of securities. It remains to consider where the balance of convenience lies.

Balance of Convenience

[20] Mr Cooper argued that the balance of convenience was against making the order. There was a substantial sum paid into court from which the plaintiffs could recover. The security given by the first defendant was over his matrimonial home, and there was no evidence suggesting that he would deal with it so as to make it unavailable in the event of judgment against him. His wife, Mrs Klein, although a co-surety, was not a party to the application, but any order would have the effect of preventing her from dealing with her interest in the matrimonial home.

[21] In answer, Mr Cowen said that the claims of the plaintiffs in the principal proceeding exceeded $2.3 million, so that the money paid into court fell far short of what they might recover. There was no evidence of any prejudice to the first defendant or his wife if the injunction were granted; there was no suggestion that they wished to deal with the property. It was anticipated that a trial could be held within the next six months. The mortgage documents entitled the bank to retain their

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8 *Banque Financiere de la Cite v Parc (Battersea) Ltd* [1999] 1 AC 221 per Lord Hoffmann at 234.

9 *Austin v Royal* (1999) 47 NSWLR 27

10 *Equity Trustees Executors & Agency Co Ltd v New Zealand Loan & Mercantile Agency Co. Ltd* [1940] VLR 201 at 207 per Lowe J; *A E Goodwin Ltd v A G Healing Ltd* (1979) 7 ACLR 481 at 487; *McColl's Wholesale Pty Ltd v State Bank of New South Wales* [1984] 3 NSWLR 365 at 378; *Russet Pty Ltd (in liq) v Bach* (unrep) of Supreme Court of New South Wales in No 2 Act 56 of 1985 23 June 1988; *Bayley & Anor v Gibsons Ltd & Ors* (1993) 1 Tas R 385 at 396-397.

11 *Bayley & Anor v Gibsons Ltd & Ors* 1993 1 Tas R 385 at 400.

12 *AE Goodwin Ltd v AG Healing Ltd* (supra) provides an example of the contrary, and in my respectful view, correct, approach: there each of 11 contributors was held entitled to be subrogated to the creditor's rights, notwithstanding that their contributions were made at different times and in different amounts.

security for seven months after the debt was paid out, so that in itself presented a possible impediment to any dealings with the property. The bank had been restrained by order in December 2000 from dealing with the securities without first giving fourteen days notice; Mrs Klein had taken no steps in respect of that order. The usual undertaking as to damages was offered. The plaintiffs' rights to subrogation would be forever lost if the order were not made.

[22] On the whole, I think that there is scant evidence of prejudice to the first defendant and his wife, as against the prospect of loss of a significant remedy to the plaintiff if successful. I consider that the order should be made. There seems no warrant, however, for making it in as broad terms as sought by the plaintiffs when there is no reason to suppose that there is any risk of any other security being dealt with. Accordingly I will make the order in the following terms:

That upon the first plaintiff Lachlan Stuart McIntosh, the second plaintiff and Stephen Charles Russell offering the usual undertaking as to damages:

1. the first defendant by himself, his servants, his agents or otherwise be restrained from dealing with registered mortgage No 701647811 over lot 287 on registered plan No 210984 until the trial of the proceeding or further earlier order.
2. the first defendant deliver any release of registered mortgage No 701647811 which is in or comes into his possession to the custody of the registrar of this honourable court to be held pending the trial of the proceeding or until further order.

[23] Some of the material as to the bank's allocation of monies paid to it by the receivers was put in by leave, not at the initial hearing but at a further hearing brought on for that purpose. That material was or should have been available on the first hearing date. The first defendant should pay the costs of the further hearing on 8 April 2003. The costs of the application otherwise will be reserved.