IN THE COURT OF APPEAL [1993] QCA 420

SUPREME COURT OF QUEENSLAND

Appeal No. 271 of 1992

Brisbane

Mr Justice Davies

Mr Justice Pincus
Mr Justice Dowsett

[Omlaw v. Delahunty]

OMLAW PTY LTD

(Plaintiff) Appellant

- and -

ROBERT WILLIAM DELAHUNTY
(Defendant) Respondent

REASONS FOR JUDGMENT - DAVIES J.A. AND PINCUS J.A.

Judgment delivered 21/10/1993

This is an appeal from a judgment given in the District Court on 4 December 1992. The appellant sought the recovery of monies owing to it pursuant to a guarantee given by the respondent. The learned trial judge dismissed the action and gave judgment for the respondent with costs to be taxed.

The facts of the case were not in dispute. On 1 January 1990, a company called Barclay Mowlem Construction Limited (Barclay Mowlem) entered into a contract with the Director-General of the Department of Administrative Services (the Director-General) for

the construction of the Maroochydore Court House. A subcontract between Barclay Mowlem and Delahunty Air Conditioning Sales and Service Pty Ltd (Delahunty Air Conditioning) was entered into on the same day. Delahunty Air Conditioning in turn made a subcontract with the appellant on 12 January 1990 and on the same day the respondent, a director of Delahunty Air Conditioning, executed a guarantee guaranteeing payment by Delahunty Air Conditioning of its debts incurred under that subcontract.

During January and February of 1990, the appellant performed work for and delivered goods to Delahunty Air Conditioning pursuant to the subcontract between them to the value of $52,227. It was a condition of that contract that payment be made by Delahunty Air Conditioning within 30 days of invoice. Invoices were delivered by the appellant to Delahunty Air Conditioning, the last of these being sent on 27 February 1990, but were not paid. It was not in dispute that Delahunty Air Conditioning was in default in the amount of $52,227 under its contract with the appellant at least from 31 March 1990.

No term of the guarantee required a demand to be made of the surety. The respondent's liability under the guarantee therefore crystallised at the time of Delahunty Air Conditioning's default: Moschi v. Lep Air Services Ltd [1973] A.C. 331 at 348. However events occurred after that date which

the respondent claims effectively discharged his liability under the guarantee.

Delahunty Air Conditioning was put into provisional liquidation on 26 April 1990. On 22 May 1990, the appellant gave a Notice of Intention to Claim Charge (Form 1) to the Director-General pursuant to s.10 of the Subcontractors' Charges Act 1974 (the Act). This Notice purported to claim a charge in the amount of $52,227 on any monies payable by the Director-General to Barclay Mowlem. However, there was no evidence that a corresponding Notice of Claim of Charge (Form 2) issued to Barclay Mowlem. Notices were also issued to Barclay Mowlem and Delahunty Air Conditioning in respect of moneys owing by Barclay Mowlem to Delahunty Air Conditioning, but these were not relied on for the purposes of this action, and their effect need not be considered.

By its solicitor, the Director-General advised that it was holding the relevant funds pursuant to the Notice of Intention to Claim Charge pending its receipt of acknowledgments of liability from Barclay Mowlem and Delahunty Air Conditioning. The learned trial judge found that $235,005.20 was in fact owed by Barclay Mowlem to Delahunty Air Conditioning pursuant to the contract between them at the relevant time. At the trial and on appeal, both parties proceeded on the basis that a valid subcontractor's charge in favour of the appellant over funds

held by the Director-General for payment to Barclay Mowlem was created on 22 May 1990, even though it was not clear that both forms necessary to create the charge had been issued. In the light of the conclusions we have reached in this case, it is unnecessary for us to consider the effect of this omission; we are prepared to assume that such a charge was effectively created.

Because the appellant took no action to enforce the charge by use of the machinery provided for in s.12 of the Act, the charge was extinguished on 22 July 1990 by the operation of sub-ss. 15(1)(b) and 15(3). The respondent alleges that the appellant, in allowing the charge to lapse, sacrificed or impaired, or by its neglect or default allowed to be lost or diminished, a security (the subcontractor's charge) with which the respondent was entitled in equity to be credited in reduction of his liability under the guarantee. As a consequence, the respondent argues, his liability as guarantor should be reduced by an amount corresponding to the value of the lost security.

The learned trial judge held that the subcontractor's charge was a "security" which could have been assigned by the appellant to the respondent under s.9(2) of the Act. Although his Honour found that no negligence, neglect, default or mala fides on the part of the appellant had been made out, he concluded that the appellant had wasted the security in deliberately choosing not

to pursue the charge, and that the respondent was therefore entitled to the equitable relief which he sought. His Honour's use of the word "deliberately" is inexplicable, particularly in view of his findings of absence of negligence, neglect and default. There was no evidence upon which he could have concluded that the appellant's failure to enforce the charge was deliberate.

The equitable principle on which the respondent relies was expressed by Dixon J. in Williams v. Frayne (1937) 58 C.L.R. 710 at 738 as follows:

> "If the guarantee is given upon a condition, whether express or implied from the circumstances, that a specific security shall be obtained, completed, protected, maintained or preserved, any failure in the performance of the condition operates to discharge the surety and the discharge is complete. But otherwise the surety can complain only if the creditor sacrifices or impairs a security, or by his neglect or default allows it to be lost or diminished, and in that case the surety is entitled in equity to be credited with the deficiency in reduction of his liability."

See also Buckeridge v. Mercantile Credits Ltd (1981) 147 C.L.R. 654 at 675.

Before this Court, the appellant argued that this principle does not apply to the facts of this case for two reasons. First, according to the appellant, equity will only relieve a surety of liability where the existence of the security creates in the

surety an equity with which the creditor must not interfere. The appellant contended that, for various reasons, the respondent here had no relevant equity with which the appellant interfered. Second, the appellant argued that even if it owed an equitable duty to the respondent as surety, its conduct in failing to enforce the charge under s. 12 was not in breach of that equitable obligation.

In its notice of appeal the appellant also relied on clause 6 of the guarantee which provided that the appellant might act as though the respondent were a principal debtor and that the respondent waived any of his rights as surety which might at any time be inconsistent with any provisions of the guarantee. However the respondent contended that the appellant could not rely on this clause which it had not pleaded or relied on below. The appellant accepted this contention and did not pursue this ground. It also accepted that it could not rely on clause 4 which provided that the appellant might grant to Delahunty Air Conditioning any time or other indulgence or compound with it without discharging or impairing the respondent's liability under the guarantee.

The rationale of the principle embodied in the first sentence of the above passage from Williams is that a surety "could not be made liable for default in the performance of a contract which he had not guaranteed": Taylor v. Bank of New South Wales (1886)

11 App.Cas. 596 at 603; see also Polak v. Everett (1876) 1 Q.B.D. 669 at 676. It was not and could not have been contended that this case came within that principle because it could not be asserted that the existence of the charge under the Act was a condition, express or implied, of the guarantee.

The principle stated in the second sentence applies to securities whenever taken. It is not dependent on the existence of a contract but upon the right of a surety, upon payment of the debt, to have an assignment of any security held in respect of that debt: Wulff v. Jay (1872) L.R. 2 Q.B. 756 at 762-3, 764, 765; and compare Ward v. National Bank of New Zealand (1883) 8 App.Cas. 755 at 766. That equitable right has been given statutory effect by s. 4 of the Mercantile Act 1867 (Qld). It is because the principle is dependent upon that right rather than upon a contract, that it does not confer an entitlement to an absolute discharge but only to one pro tanto. The principle applies to securities obtained after the giving of the guarantee, whether the guarantor knows of them or not, and to omissions as well as acts of the creditor: Wulff; see also Forbes v. Jackson (1882) 19 Ch.D. 615 at 621.

Because the respondent's liability under his guarantee crystallised at the time of default by Delahunty Air Conditioning, that is at least by 31 March 1990, he then became contingently entitled to an assignment of any securities held by

the appellant in respect of the debt. But because the charge under the Act did not come into existence until 22 May 1990, had the respondent paid the debt at any time between that earlier date and 22 May 1990, there would have been no charge under the Act to which he could have claimed to be entitled. It is unnecessary to consider whether, if, after the notice of claim of charge had been given, and before the expiration of two months from that date, the respondent had paid the debt, he would have been entitled to an assignment of that charge pursuant to s. 9(2) of the Act. For the reasons given below, at no material time did the appellant owe the respondent any duty to commence proceedings in respect of the charge.

From 31 March 1990 the appellant was entitled to exercise such of its remedies against the principal debtor, or against any security which it held, as it saw fit. It owed no duty to the respondent to pursue any of those remedies and consequently its mere failure to do so did not discharge the respondent: Wright v. Simpson (1802) 6 Ves.Jun. 714 at 734, 31 E.R. 1272 at 1282; Samuell v. Howarth (1817) 3 Mer. 272 at 278, 36 E.R. 105 at 107; Eyre v. Everett (1826) 2 Russ. 381, 38 E.R. 379; Black v. Ottoman Bank (1862) 15 Moo.P.C.C. 472 at 483, 15 E.R. 573 at 577; McMahon v. Young (1876) 2 V.L.R.(L.) 57 at 62-3; Carter v. White (1883) 25 Ch.D. 666 at 670, 672; O'Day v. Commercial Bank of Australia (1933) 50 C.L.R. 200 at 223-4; Waung v. Subbotovsky [1968] 3 N.S.W.R. 499 at 508; Jones v. Bank of New

South Wales (Supreme Court of Queensland, Connolly J., 19 April 1979, unreported); State Bank of Victoria v. Parry (1989) 7 A.C.L.C. 226 at 229; China & South Sea Bank Ltd. v. Tan Soon Gin [1990] 1 A.C. 536; A.N.Z. Banking Group Ltd. v. Walsh (Supreme Court of Victoria, Beach J., 8 May 1991, unreported); Mailman v. Challenge Bank Ltd. (N.S.W. Court of Appeal, 12 December 1991, unreported).

The law appears to have put into a special category a mere omission on the part of a creditor to exercise rights under a mortgage or other security, even if doing so causes the security to be "lost or diminished", to use the expression of Dixon J. in Williams v. Frayne in the passage quoted above. It appears that the guarantor cannot then complain, even if the result is that the creditor's indolence foreseeably causes the guarantor grievous loss. The point is, we think, too well established to be reconsidered in an intermediate appellate court.

One of those remedies which the appellant was entitled to pursue after 31 March 1990 was its statutory remedy by way of charge under the Act. That the statutory procedure under the Act, including the giving of the notice, is a procedure to obtain payment of money, appears from s. 12. The respondent cannot complain because the appellant has not pursued that procedure.

Nor is it necessary to consider whether, in a case such as this,

a creditor owes a duty to a surety, breach of which would entitle the surety to a discharge pro tanto, in respect of such degree of negligence as to imply connivance and amount to fraud (Black at 577) or possibly even in respect of wilful neglect or default (Rowlatt on Principal and Surety, 4th ed. at 186, see also at 132; see also Buckeridge at 671 per Aickin J.). Ex p. Mure (1788) 2 Cox 64, 30 E.R. 30 (conscious forbearance to sue), Wulff v. Jay (failure to take possession with knowledge that bankruptcy of the debtor was impending and imminent) and Rainbow v. Juggins (1880) 5 Q.B.D. 138 (wilfully abandoning a security by failing to value it in a liquidation after a warning that such failure would discharge the surety) may be explicable on this basis. Nothing of the sort was alleged or established here.

It was asserted before us by counsel for the respondent that the respondent was never told that a notice of claim of charge had been given. There is no evidence, one way or the other, upon this. That is not surprising because it was not in issue below; it was never alleged that the appellant was in breach of any duty to the respondent in failing to inform him that a notice of claim of charge had been given. It has sometimes been said that the reason for the principle that a creditor is under no duty to a surety to enforce a security is that the surety may pay out the creditor and enforce the security: McMahon at 63; Carter at 670, 672; Jones at 6; China and South Sea Bank Ltd at 545;

Mailman at 15. It is true that, if we were to accept as a fact the respondent's contention that he did not know of the existence of the charge, he may have lacked the incentive to pay out the debt which a surety, knowing of the existence of such charge, might have had. But his right, at any time after 31 March 1990, to pay out the debt and thereby to become entitled to enforce any rights which the appellant had in respect of the debt did not depend on his knowledge of the nature and extent of those rights.

In our view the learned trial judge was wrong in concluding that the appellant owed a duty to the respondent to take proceedings pursuant to s. 12 of the Act to enforce the charge. We would therefore allow the appeal and set aside the judgment below. There should be judgment for the appellant in the sum of $74,550.00, being $52,227.00 together with interest thereon at 12 per cent per annum from 31 March 1990 to the date of this judgment. The appellant should have its costs of appeal and of the proceedings below.

IN THE COURT OF APPEAL

SUPREME COURT OF QUEENSLAND

Appeal No. 271 of 1992

Brisbane

[Omlaw Pty Ltd v. Delahunty]

BETWEEN:

OMLAW PTY LTD
(Plaintiff) Appellant

- and -

ROBERT WILLIAM DELAHUNTY
(Defendant) Respondent

DAVIES J.A.
PINCUS J.A.
DOWSETT J.

Judgment delivered 21/10/1993

JOINT REASONS FOR JUDGMENT OF DAVIES AND PINCUS JJ.A.; DOWSETT J. DISSENTING

APPEAL ALLOWED. SET ASIDE THE JUDGMENT BELOW. ORDER THAT THERE BE JUDGMENT FOR THE APPELLANT IN THE SUM OF $74,550.00. FURTHER ORDER THAT THE APPELLANT HAVE ITS COSTS OF THE APPEAL AND THE PROCEEDINGS BELOW.

CATCHWORDS: **GUARANTEE AND INDEMNITY - ACTIONS AGAINST SURETY - Creditor appeals against dismissal of action to enforce guarantee - Subcontractor's charge in creditor's name extinguished when creditor failed to take action to enforce charge - Whether guarantor entitled to pro tanto relief because creditor guilty of neglect or default which allowed security to be lost or diminished**

Mercantile Act 1867, s. 4
Subcontractors' Charges Act 1974, ss. 9, 10, 12, 15

Black v. Ottoman Bank (1862) 15 ER 573
Buckeridge v. Mercantile Credits Ltd (1981) 147 CLR 654
Carter v. White (1883) 25 Ch D 666
China & South Sea Bank v. Tan Soon Gin [1990] 1 AC 536
Forbes v. Jackson (1882) 19 Ch D 615
Jones v. Bank of New South Wales (Sup.Ct Qld, 19.4.79,
Mailman v. Challenge Bank Ltd (NSW Court of Appeal, 12.12.91, unrep.)
McMahon v. Young (1876) 2 VLR(L) 57
O'Day v. Commercial Bank of Australia (1933) 50 CLR 200
Polak v. Everett (1876) 1 QBD 669
Waung v. Subbotovsky [1968] 3 NSWR 499
Williams v. Frayne (1937) 58 CLR 710
Wulff v. Jay (1872) LR 2 QB 756

Counsel: Mr J. Sullivan for the Appellant
Mr M. Martin for the Respondent

Solicitors: W.T. Purcell Chadwick & Skelly for the Appellant
Steindl Robertson McPherson for the Respondent

Hearing Date: 28 April 1993

THE COURT OF APPEAL

SUPREME COURT OF QUEENSLAND

Appeal No. 271 of 1992

Brisbane

Before Mr. Justice Davies
Mr. Justice Pincus
Mr. Justice Dowsett

[Re: Omlaw Pty Ltd & Others]

BETWEEN:

OMLAW PTY LTD

Plaintiff/Appellant

AND:

ROBERT WILLIAM DELAHUNTY

Defendant/Respondent

REASONS FOR JUDGMENT - DOWSETT J.

Judgment delivered 21/10/93

The basic facts of the case appear sufficiently from the reasons for judgment prepared by my brothers Davies and Pincus. Concerning the absence of evidence of service of a Form 2 upon Barclay Mowlem Construction Ltd, no point was taken at the trial or on appeal. I proceed upon the basis that either it was common ground that the appropriate notice had been given or alternatively, the failure to give such notice did not invalidate the charge.

The point of the appeal arises from a collection of cases concerning the circumstances in which the liability of a surety will be either discharged completely or reduced pro tanto as a result of conduct of the creditor in connection with securities available to the latter.

An authoritative statement of the principle appears in the judgment of Dixon J (as he then was) in Williams v Frayne (1937) 58 CLR 710 at p. 738 as follows:-

> "If the guarantee is given upon a condition, whether express or implied from the circumstances, that a specific security shall be obtained, completed, protected, maintained or preserved, any failure in the performance of the condition operates to discharge the surety and the discharge is complete. But otherwise the surety can complain only if the creditor sacrifices or impairs a security, or by his neglect or default allows it to be lost or diminished, and in that case the surety is entitled in equity to be credited with the deficiency in reduction of his liability."

The High Court again considered the matter in Buckeridge v Mercantile Credits Limited (1981) 147 CLR 654. At pp. 668-9, Aickin J said:-

> "The authority relied upon i.e. Duncan Fox & Co v North & South Wales Bank and cases which followed it, established a much narrower proposition, namely that: A surety paying off the debt has always been held entitled to any securities which may have been given for the debt by the principal to the creditor. This right does not depend upon contract, but upon the equity that the surety should not have the whole thrown upon him by the choice of the creditor not to resort to the remedies in his power.' (Rowlatt on Principal and Surety, 3rd ed. (1936), p. 205)"

At p. 671, his Honour continued:-

> "Another aspect of the argument for the appellants which calls for separate comment was that the respondent had prejudiced the value to them of the

mortgage, to the benefit of which they were entitled, and that their liability to the respondent was thereby discharged to the extent that the acts done by the respondent reduced the amount to which they should be credited by reason of the sale of the property. They relied on the proposition stated by Lord Watson in Taylor v. Bank of New South Wales (1886) 11 App. Cas. 596 at p. 603:

> 'The present case would, in such event, have been within the rule of Pearl v Deacon (1857) 24 Beav. 186; 1 De. G & J 461 [44 ER 802], where the creditor had, by his own act, rendered unavailable part of the security, to the benefit of which the surety was entitled, and the latter was held to be discharged, not absolutely, but only pro tanto.'

Pearl v Deacon was a case in which the creditor destroyed the security by the exercise of a paramount right, in that case by distraining for rent furniture mortgaged to secure the amount guaranteed, and it was held that the surety was discharged pro tanto. It is not altogether clear whether such pro tanto discharge is available only when there is wilful neglect or default; se Rowlatt, at pp. 289-291; Carter v White (1883) 25 Ch D 666, at p. 670. However that is of no significance in the present case because the principle referred to by Lord Watson is subject to the terms of the guarantee itself; see, e.g, Bank of Adelaide v Lorden (1970) 127 CLR 185. The guarantee in the present case contains in the latter part of cl. 2 an express provision that the liability of the guarantors (the appellants) is not to be affected by any release of or dealing with any property comprised in any security held by the mortgagee (the respondent). That provision is sufficient to prevent any such right as is relied upon from arising."

Brennan J said at pp. 674-5:-

"Next it was submitted that the exercise of powers under the debenture had worsened the appellants' position as guarantors by diminishing the value to them of the mortgage to the benefit of which they were entitled, and that they were discharged from their liability to the extent to which the respondent's conduct had worsened their position. It was not argued that the appellants were entitled to be discharged because of breach of their agreement with the respondent, but it was submitted that the present case is of the kind to which Lord Watson referred in Taylor v Bank of New South Wales ... (His Honour set out the passage quoted by Aickin J)

> In a case where the act of a creditor does not discharge a surety, but the creditor has nonetheless sacrificed or impaired a security, or by his neglect or default allowed it to be lost or diminished, the surety is entitled in equity to be credited with the deficiency in reduction of his liability (Williams v Frayne, per Dixon J)."

The Court held that the sureties had bargained away their rights by the terms of the surety agreement. No such argument was advanced in the present case. Section 4 of the Mercantile Acts gives statutory recognition to the right of a surety to securities held by his creditor but is not otherwise relevant to this case.

There are two quite distinct situations postulated in the cases. The first is complete discharge of the surety by reason of the creditor's breach of a contractual obligation concerning securities. The second is pro tanto discharge of the surety's obligation by operation of an equitable principle where conduct of the creditor in connection with securities has reduced their value to the surety. Although there are numerous cases demonstrating the application in practice of this latter principle, present purposes will be satisfied by reference to a small number of them.

In Watts v Shuttleworth (1860) 5 H & N 235, the defendant agreed with the plaintiff to guarantee the due performance of works pursuant to a contract between the plaintiff and a third party. That agreement provided that the plaintiff should effect insurance in respect of the subject property, but he failed to do so. Pollock CB said at p. 247:-

> "The rule upon the subject seems to be that if the person guaranteed does any act injurious to the surety, or inconsistent with his rights, or if he omits to do any act which his duty enjoins him to do, and the omission proves injurious to the surety, the latter will be discharged ... We think the plaintiff ought to have insured. It therefore seems to us that the plaintiff has omitted to do an act which his duty towards the defendant required him to do; that if he had done it the defendant would have been relieved to the extent of the insurance; that the omission therefore was injurious to him, and that he has been thereby discharged from the suretyship."

The report elsewhere suggests that although the surety probably knew of the covenant to insure, that fact was irrelevant. The principle invoked was said to be that enunciated in Pearl v Deacon, a case of pro tanto discharge in equity. (See pp. 247 and 249.)

The second seminal case is the decision in Wulff v Jay (1872) LR 7 QB 756. In that case, the plaintiffs lent a sum of money to third parties for the repayment of which the defendant became surety. The defendant was a party to the original mortgage deed, and that deed required the third parties to assign certain property to the plaintiffs as security for the debt. The deed was a bill of sale but was not appropriately registered. The third parties became insolvent to the plaintiffs' knowledge, but the latter did not take possession of the property the subject of the security. Subsequently, the third parties went into bankruptcy and the property was seized and sold by the trustee. The plaintiffs sought to recover the debt from the defendant surety. At p. 762, Cockburn CJ said:-

> "Now, I think there was a twofold laches on the plaintiffs' part - laches in the first place in not

> registering the bill of sale. If they had registered it the effect would have been that the fixtures would have been protected. ... But then there was laches if possible of a more serious description affecting not only the moveables but the fixtures also. The plaintiffs might have entered and taken possession upon the interest not being paid at the time when it became due. Instead of doing this, however, they allow the mortgagors to remain in possession when they see that bankruptcy is impending and imminent. ... I think, looking at all the circumstances, it is impossible to say that the plaintiffs did what they ought to have done to realise the securities they possessed. Cases have been cited and authorities have been referred to ... which abundantly establish that which is a common and well-known proposition, that where a debt is secured by a surety, it is the business of the creditor, where he has security available for the payment and satisfaction of the debt, to do whatever is necessary to make that security properly available. He is bound, if the surety voluntarily proposes to pay the debt, to make over to the surety what securities he holds in respect of that debt, so that, being satisfied himself, he shall enable the surety to realise the securities and recoup himself the amount of the debt which he has had to pay. That is now a well-known proposition. Here, by registering the bill of sale, and by afterwards availing themselves of the power which they possessed to take possession, the plaintiffs might have secured the payment of the debt to themselves, or by protecting the securities and holding them in their hands they could have made them over to the surety when the surety was willing, or was called on, to pay; but by omitting to do what was necessary in order to place themselves in that position, and by allowing bankruptcy to supervene so as to enable the trustee under the bankruptcy to take possession of these goods adversely, it is clear that they have placed the surety in a position very detrimental and prejudicial to the surety; and for that the surety ought to have, according to the general doctrine a remedy."

The remedy was credit for the value of the lost security. Hannen J, at p. 764, quoted with apparent approval an extract from the judgment in Rees v.Barrington 2 White & Tudor's LC, 4th ed., at p. 1002 as follows:-

> "As a surety, on payment of the debt, is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship, if the creditor who has had, or ought to have had, them in his full possession or power, loses them or permits them to get into the possession of the debtor, or does not make them effectual by giving proper notice, the surety to the extent of such security will be discharged. A surety, moreover, will be released if the creditor, by reason of what he has done, cannot, on payment by the surety, give him the securities in exactly the same condition as they formerly stood in his hands."

Quain J (who was also the trial Judge) said at p. 766:-

> "The mortgagees well knew the state of their debtors, one of the mortgagees being the attorney who conducted the bankruptcy proceedings. The result is, that the mortgagees stand by and allow the whole of this property to be swept away by the trustee in bankruptcy, and sold for the benefit of the estate. It appears to me, therefore, that that property which has been allowed to be sold by the mortgagees, is the very property which the surety was entitled to have handed over to him if he paid the sum that was due, viz., £307/10s. It seems to me to fall precisely within the rule that has been referred to and that pro tanto the surety is discharged, and the verdict ought to stand only for £7/10s."

Dixon J in Williams v Frayne (supra) at p. 738, treated the decision in Wulff v Jay as concerning a guarantee given upon condition that a specific security be obtained, completed, protected, maintained or preserved, and this seems to have been so in fact. However the surety's obligation was reduced pro tanto, not discharged, indicating reliance on the equitable principle applicable to all securities rather than a contractual breach.

The third case is the decision of the Court of Appeal in Polak v Everett (1876) 1 QBD 669. In that case, a third party

was indebted to the plaintiffs and entered into a deed to secure repayment which involved the assignment of shares in a company to be formed and a further charge over book debts. The defendant guaranteed performance of the agreement in certain particulars. The plaintiffs and the third party subsequently agreed that the plaintiffs' interest in the book debts should be surrendered to the third party. The plaintiffs then sued the defendant on the guarantee. At p. 675, Blackburn J said:-

> "For instance, there is Wulff v Jay - and that case was perfectly rightly decided - where a person is a creditor with a pledge or surety he is in equity bound to account not only for the money which he has actually made out of the pledge, but also for the moneys he might, ought, and should have made out of the pledge, and he must allow for that whether he made them or not, and if by laches he has diminished the value of the pledge he is bound to allow for the sum he ought to have made. But his laches does not discharge the surety, for it does not come within the principle which applies where the surety's rights have been changed or varied. His rights remain as before.
> The case seems to be like the case where the creditor does not choose to sue the debtor. That does not discharge the surety, for the surety's right remains untouched. So in the case where there is a failure to make the most he could of the pledge, that does not in the slightest degree discharge the surety, though the amount which ought to have been recovered by making a proper use of it is to be allowed in reduction of the debt. In the present case it is not a question of laches, or not making the best of the pledge that could be made, but it is a case of preventing the surety having any recourse against those book debts at all. There are other cases, but I do not think it is necessary to go into them. There is a distinction made in equity between those rights of the surety which he acquired at the time when he entered into the suretyship, such as securities a creditor then held, and other rights, and he has a right to all those, and Mayhew v Crickett establishes, if that security is destroyed, the debt is gone. There are other cases which turn upon this. After the security is established, the surety has a

> right to have the benefit of new securities, but those not being a part of the original right it is a different question whether the dealing with those would discharge the surety. The present case does not come within that principle. "

In the context of discharge for loss of a security, his Lordship distinguished between securities acquired at the time of becoming surety and after - acquired securities, however in the discussion of pro tanto reduction for laches or other diminution of the security, no such distinction was drawn. The case suggests that a surety is entitled to pro tanto reduction of his indebtedness for any reduction in value of the available securities caused by the actions of the creditor, including delay in, or not enforcing them.

Polak v Everett was considered and approved in Carter v White (1883) 25 Ch D 666 where Cotton LJ said at p. 670:-

> "... The principle is this, that if there is a contract express or implied that the creditor shall acquire or preserve any right against the debtor, and the creditor deprives himself of the right which he has stipulated to acquire, or does anything to release any right which he has, that discharges a surety; but when there is no such contract, and he only has a right to perfect what he has in his hand, which he does not do, that does not release the surety unless he can show that he has received some injury in consequence of the creditor's conduct. That is laid down by Mr Justice Blackburn in Polak v Everett. Here although these acceptances were not perfected, there is no evidence that anything could have been recovered from the debtor if they had been; therefore the surety is not entitled to anything in the nature of damages for being deprived of an advantage which he otherwise would have had. The surety is not now prevented from getting the acceptances filled up, though of course they would not be of any use if the statute were pleaded. A surety is not discharged merely by the negligence of the creditor. If he had required them to be enforced, and the creditor had refused, the surety might have

> been discharged, but he is not discharged merely by the laches of the creditor, for this reason, that the surety may at any time pay off the debt, and sue the debtor in the name of the creditor, or call on him to sue."

It was there argued that the surety had been discharged because the creditor had failed to insert the name of a drawer in certain bills of exchange deposited with the creditor by the debtor, who had accepted them. Any action was statute-barred. The bills were, in any event, worthless as the only party liable on them was the debtor. Thus it was not possible to show any damage to the surety through loss of the security. The surety could only hope to avoid liability by proving discharge for breach of the contract of surety by the creditor. Cotton LJ recognised that inactivity causing demonstrable loss to the surety might lead to a claim against the creditor in the amount of such loss. When his Lordship spoke of discharge in the passage quoted above, he was referring to total discharge for breach of the contract of suretyship, and not to pro tanto reduction in indebtedness pursuant to the equitable rule, the latter subject not being relevant in that context. The other judgments should be similarly understood.

The most recent authoritative pronouncement is the decision of the Privy Council in China & South Sea Bank Ltd v Tan Soon Gin [1990] 1 AC 536. Their Lordships were there concerned with an allegation of discharge and a claim for pro tanto reduction. The summaries of argument suggest that the matter had previously proceeded without reference to the line of

cases to which I have been referring, which was first raised in the respondent's submissions before the Judicial Committee. This may explain the absence of any reference to Polak v Everett and other associated cases. Their Lordships were referred only to Watts v Shuttleworth and Wulff v Jay.

At first glance, China & South Sea Bank Ltd v Tan Soon Gin seems to be an extreme example of the leeway traditionally allowed to creditors in enforcing securities. The plaintiff bank made a loan to a third party which was guaranteed by the defendant. The third party gave security for the debt and interest by share mortgage to a value allegedly twice that of the advance. At the time of default, the shares were still worth more than the outstanding amount, but the plaintiff did not exercise its power of sale. The shares subsequently became worthless, and the plaintiff sought payment from the defendant. As the original advance was in the sum of HK$30 million, the loss allegedly attributable to the delay in exercising the power of sale was quite substantial. However the dramatic decline in the value of the shares occurred over a fairly short period of time. The loan was made in May, 1982, at which time the guarantee was also given. A deed of variation, to which the defendant was a party was executed in August, 1982, rendering the debt repayable in November, 1982. Demand was made upon the defendant on 31st October, 1983 and the writ was issued in November, 1983. Thus the period between default and demand was something less than one year, notwithstanding the disastrous

decline in the value of the securities in that time. After reference to Watts v Shuttleworth and Wulff v Jay, their Lordships said at p. 545:-

> "In the present case the security was neither surrendered nor lost nor imperfect nor altered in condition by reason of what was done by the creditor. ... If the creditor chose to exercise his power of sale over the mortgaged security he must sell for the current market value but the creditor must decide in his own interests if and when he should sell. The creditor does not become a trustee of the mortgaged securities and the power of sale for the surety unless and until the creditor is paid in full and the surety, having paid the whole of the debt is entitled to a transfer ...
>
> The creditor is not obliged to do anything ... The surety contracts to pay if the debtor does not pay and the surety is bound by his contract. If the surety, perhaps less indolent or less well protected than the creditor, is worried that the mortgaged securities may decline in value then the surety may request the creditor to sell and if the creditor remains idle then the surety may bustle about, pay off the debt, take over the benefit of the securities and sell them. No creditor could carry on the business of lending if he could become liable to a mortgagor and to a surety and to either of them for a decline in value of mortgaged property, unless the creditor was personally responsible for the decline. Applying the rule as specified by Pollock CB in Watts v Shuttleworth, ..., it appears to their Lordships that in the present case the creditor did no act injurious to the surety, did no act inconsistent with the rights of the surety and the creditor did not omit any act which his duty enjoined him to do. The creditor was not under a duty to exercise his power of sale over the mortgaged securities at any particular time or at all." (Emphasis added)

Although the case appears to be a stark example of the absence of any obligation upon the creditor to act to protect the position of the surety, in the end it establishes only that to decline to exercise the power of sale at a time when the value of the security is falling does not of itself constitute

breach of any duty to the surety.

In the course of argument before us, this proposition was repeatedly stressed by counsel for the appellant, who tended to treat it as synonymous with the proposition that a creditor is always entitled to do nothing concerning his securities. Such a broad assertion cannot be reconciled with the passage in Williams v Frayne (supra) to the effect that:-

> "... the surety can complain ... if the creditor sacrifices or impairs a security, or by his neglect or default allows it to be lost or diminished ... "

To similar effect, and also apparently inconsistent with such a justification of inactivity is the passage in Buckeridge v Mercantile Credits Ltd (per Brennan J) at p. 675:-

> "... in a case where the act of a creditor does not discharge a surety, but the creditor has nonetheless sacrificed or impaired a security, or by his neglect or default allowed it to be lost or diminished, the surety is entitled in equity to be credited with the deficiency ..."

Both passages contemplate circumstances, short of a contractual obligation to act, where failure to act (neglect or default) resulting in loss to the surety will result in reduction in the surety's indebtedness. This is consistent with Wulff v Jay, Polak v Everett and Carter v White (per Cotton LJ). If neglect or default may have such consequences, it is obviously incorrect to assert as a general proposition that a creditor can never be exposed to liability for loss suffered by a surety as a result of inactivity.

The appellant's written submission was that whilst equity may require the creditor to perfect a security, that duty does

not require him to enforce it unless he is guilty of such a degree of negligence in failing to do so as to imply connivance and amount to fraud. This proposition is also difficult to reconcile with the observations made by Dixon J and Brennan J, who made no mention of connivance or fraud, nor did they distinguish between loss suffered as a result of failure to perfect a security and loss caused by failure to enforce a security. The judgment of McTiernan J in O'Day v Commercial Bank of Australia Ltd (1933) 50 CLR 200 at pp. 223-4 has been cited as authority for such a proposition, however this mistakes the decision. His Honour dealt with loss of security at the top of p. 223, recognizing the equitable principle to which I have referred, although not distinguishing between discharge and pro tanto reduction. The "second ground", dealt with on pp. 223-4, was conduct by the creditor designed to destroy the principal debtor's credit and ability to pay. See p. 222 of the judgment where the three points for consideration are identified.

McTiernan J, relying on Black v Ottoman Bank (1862) 15 Moo. PCC 472, considered that not suing the principal debtor would not discharge the surety in the absence of connivance amounting to fraud. Notwithstanding the observation to the contrary by Malcolm CJ in State Bank of Victoria v Parry (1989) 7 ACLC 226 at p. 229, neither O'Day nor Black v Ottoman Bank is authority for the proposition that a creditor has no duty to enforce a security. The latter case is authority for the proposition that a creditor owes no duty to the surety to sue

the principal debtor, but that is a very different thing. In O'Day, McTiernan J followed that decision, but the other members of the court did not consider it. A surety expressly undertakes to ensure that the debtor will pay. He should not be heard to complain if the creditor relies upon that undertaking in preference to himself suing the debtor. That does not lead in logic to the proposition that a creditor may, by inactivity, give up the benefit of securities to which the surety would have been entitled, but still look to the surety for full satisfaction, notwithstanding that the surety's exposure has been so increased. Some reliance was placed upon the decision of the Court of Appeal of New South Wales in Subbotovsky v Waung (1968) 72 SR(NSW) 242 at pp. 255-6. The court was there concerned with a claim upon a guarantee of performance of a contract, the contract and the guarantee having been entered into in China. Judgment was entered against the guarantor at trial and on appeal, amongst other points raised, the guarantor sought to add a claim that his obligation had been discharged as a result of failure by the creditor to enforce its securities. Sugerman JA (with whom the other members of the Court concurred) said:-

> "There are no doubt many grounds upon which a surety may be discharged absolutely or pro tanto by the conduct of the creditor ... These grounds do not, however, extend so far as the facts alleged in the pleas sought to be added by amendment or relied upon ... These amount to no more than allegations of mere inactivity on the part of the creditor in not proceeding promptly against the principal debtor or the security or in not so proceeding before taking action against the surety on his guarantees. There is

> no principle of our law which assigns to such mere inactivity the effect of discharging the surety. This assumes of course that our law is applicable; but I do not in any event agree that the question is one of procedure for the lex fori. It is a question of discharge of the obligation, which is one for the proper law of the contract.
>
> The surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt, or himself to pay off the debt, so that when he has paid it off he is at once entitled in the creditor's name to sue the principal debtor ... 'The surety has no right to say that he is discharged from the debt which he has engaged to pay, together with the principal, if all that he rests upon is the passive conduct of the creditor in not suing. He must himself use due diligence, and take such effectual means as will enable him to call on the creditor either to sue or give him, the surety, the means of suing'... The surety 'is not discharged merely by the laches of the creditor, for this reason, that the surety may at any time pay off the debt, and sue the debtor in the name of the creditor or call on him to sue' (Carter v. White, per Cotton LJ). 'Is it the law that a creditor who neglects to sue his debtor till the statute has run will thereby discharge the surety? There is no decision to that effect. On the contrary, the true principle is that mere omission to sue does not discharge the surety, because the surety can himself set the law in operation against the debtor.' (ibid at p. 672, per Lindley LJ)."

As I have previously demonstrated, Carter v White is authority for the proposition that failure to sue will not lead to discharge of the surety, however Cotton LJ recognized that such conduct, if it caused loss to the surety, might result in pro tanto reduction of the latter's obligation to the creditor. If Sugerman JA intended that his remarks apply to both absolute discharge and pro tanto reduction, then they are not supported in the latter case by the decision in Carter v White. Such a proposition is also difficult to reconcile with Williams v Frayne and Buckeridge.

In G R Mailman and KR Mailman v Challenge Bank Limited (unreported, Court of Appeal, New South Wales, CA 40338/91, CD 50587/90, judgment delivered 12th December, 1991), sureties claimed reduction in their indebtedness because of loss of value of a security brought about by the failure of the creditor to realise that security at a time when market values were falling, notwithstanding a request by the surety that the property be sold. Sheller JA referred to the judgment of the Privy Council in China & South Sea Bank Ltd v Tan Soon Gin (supra), suggesting that the decision was, "largely if not entirely against the sureties' submissions". His Honour also referred to the judgment of McTiernan J in O'Day v Commercial Bank of Australia Limited (supra) as being consistent with that decision. As I have said, neither decision challenges the equitable principle, nor does either exclude inactivity in all its forms as a possible basis for operation of that principle. Sheller JA referred to the decision of Aickin J in Buckeridge (supra), particularly at p. 670, to the effect that there is no entitlement to subrogation until the surety has paid the debt. Sheller JA then asserted that:-

> "If the surety cannot or does not pay the amount the entitlement is not available to him and he has no other basis of complaining, in the absence of mala fides, about the order in which the creditor pursues the remedies available to him."

As a statement of principle, this proposition may be correct. However, Aickin J, later in the judgment, at p. 671, considered pro tanto discharge in equity. Although the

operation of the equitable doctrine was excluded in that case by the terms of the surety agreement, neither Aickin J nor Brennan J suggested that payment by the surety was a condition precedent to its operation in other cases. If Sheller JA meant that there was no entitlement to pro tanto reduction until the surety had paid the creditor, then that proposition finds no support in Williams v Frayne or Buckeridge. In practical terms, it is also inconsistent with modern notions of equitable set-off.

In the end, I conclude that it is inappropriate to seek to supplant the language used by Brennan J in Buckeridge (supra), given that his Honour's judgment enjoyed the support of the majority of the court. A creditor who sacrifices or impairs a security or, by his neglect or default allows a security to be lost or diminished must credit the surety with the deficiency.

Where loss occurs as a result of inactivity, difficulties arise if one equates a decision to take no action with a failure to take any action. There may be inactivity with respect to a particular security for a number of different reasons. Possibilities which occur to me are:-

(a) A deliberate decision by the creditor in his own best interests not to enforce the security;

(b) A decision by the creditor to "wait and see";

(c) Oversight by the creditor;

(d) A decision by the creditor to allow an indulgence to the debtor;

(e) A decision by the creditor not to act, made with the

intention of injuring the surety or some other collateral purpose.

Clearly, the cases support a creditor who decides in his own best interests not to enforce a security. Similarly, a creditor who chooses to wait and see is also protected as he, too is acting in his own perceived best interests. It is in these situations that the courts have traditionally held that the creditor owes no duty to the debtor or to the surety as to whether or not he enforces his security. What of the situation in which the creditor fails to act through inadvertence? The words "neglect or default" obviously imply circumstances in which the creditor ought to have acted. By definition, I am not here concerned with any contractual obligation, but with the circumstances in which equity will require that a creditor act and where it will constitute "neglect or default" not to do so. I will return to this point in a moment. As to (d) and (e), there is much learning concerning the former, and the latter situation is almost certainly one in which relief would be given in the event that the surety suffered loss. I need not further consider either case for present purposes. There may be evidentiary difficulties in determining into which category (if any), a particular state of inactivity falls, but the exercise is not impossible.

The cases yield little assistance in defining the circumstances in which inactivity will constitute neglect or default. Mayhew v Crickett (1818) 2 Swans 185 at p. 191

suggests that a creditor who levies execution against the debtor and then withdraws may thereby discharge a surety. In Wright v Simpson (1802) 6 Ves jun 714 at p. 734, Lord Eldon said:-

> "As to the case of principal and surety, in general cases I never understood, that as between the obligee and the surety there was an obligation of active diligence against the principal. If the obligee begins to sue the principal, and afterwards gives time, there the surety has the benefit of it. (Rees v Berrington, 2 Ves, jun. 540; and the note, 544.) But the surety is a guarantee; and it is his business to see, whether the principal pays, and not that of the creditor. The holder of the security therefore in general cases may lay hold of the surety; and till very lately even in the circumstances, under which the surety would not have had the same benefit, that the creditor would have had. But in late cases, provided there was no risk, delay, or expense, as in the case put, of the money in the next room, indemnifying against the consequences of risk, delay, and expense, the surety has a right to call upon the creditor to do the most he can for his benefit; and the latter cases have gone farther. It is now clear, that if the surety deposits the money, and agrees, that the creditor shall be at no expense, he may compel the creditor to prove under a Commission of Bankruptcy, and give the benefit of an assignment in that way. "

In Forbes v Jackson (1882) 19 Ch D 615 at pp. 621-2, Hall VC said:-

> "The principle is that the surety in effect bargains that the securities which the creditor takes shall be for him, if and when he shall be called upon to make any payment, and it is the duty of the creditor to keep the securities intact; not to give them up or to burthen them with further advances."

In Williams v Frayne (supra) at pp. 738-9, Dixon J described the duty of the creditor to the surety as, "a duty to take reasonable care that the benefit of the security ... should not be lost." These terms, so well-understood in our jurisprudence, adequately define, "neglect or default", the

expression used by Dixon J in that case and by Brennan J in Buckeridge. Such a duty is wide enough to include inactivity causing loss or reduction in value of the security, whether the inactivity be as to perfecting or enforcing the security, subject, in all cases, to the overriding right of the creditor to act or decline to act in his own best interests.

In cases such as China & South Seas Bank Ltd v Tan Soon Gin and Mailman, where the security is devalued by delay but not lost, the surety faces a further problem. The rule requires loss or reduction in value of the security, caused by neglect or default by the creditor, and causing loss to the surety. Where the value of a security simply declines over time, a surety may be said to lose as a result of the creditor's delay in enforcing it, however the decline in value (as opposed to the surety's loss) cannot be described as "caused" by such delay. It is caused by market forces. The equitable rule is therefore not applicable. This may be the true basis for excluding the simple devaluation cases from the rule. Such a distinction is implicit in the first few lines of the extract from China & South Seas Bank Ltd v Tan Soon Gin quoted above.

I turn now to consider the facts of this case. The guarantee was executed on 12th January, 1990 and the final invoice was rendered on 27th February, 1990. Demand was made upon the respondent on 17th April, 1990. A matter which received little attention before us was that on 26th April, 1990 the respondent wrote to the solicitors for the appellant

acknowledging receipt of the demand. In that letter the respondent said:-

> "Could you please advise if your client has made any effort to secure its position by way of a Subcontractor's charge on the main contractor Barclay Mowlem as my understanding is there are more than sufficient moneys owing to Delahunty Air Conditioning Sales and Service Pty Ltd against which a charge could be made.
>
> Your client rang the office of Delahunty Air Conditioning soon after the provisional liquidator was appointed and was told it should lay a charge as soon as possible.
>
> Your early response would be appreciated." (See ex.30)

It seems at least likely that the subsequent claim of charge was as a result of this letter. The notice was given on 22nd May. On 18th June, the Crown Solicitor advised the appellant's solicitors that:-

> "... moneys are being held from a payment to Barclay Mowlem Constructions Ltd pursuant to the 'Notices of Intention to Claim Charge' served on your client's behalf.
>
> The money held will not be paid directly to your client unless I receive an acknowledgment of liability from the appropriate contractors.
>
> In the absence of such an acknowledgment my client would consider its position in relation to a payment into court once proceedings are commenced by your client."

On 2nd July, solicitors for the appellant enquired of the liquidators of Delahunty Air Conditioning whether or not they would acknowledge liability for the benefit of the Crown Solicitor. The liquidators, by their solicitors replied on 1st August, 1990 confirming that the amount claimed was correct

and that such sum was the subject of the notice of claim of charge. This response is somewhat Delphic, as one might expect.

On 4th December, 1990 the Crown Solicitor wrote indicating that in the absence of a reply within seven days, the charge would be deemed to be extinguished pursuant to the provisions of s.15 of the Act. It is not clear what prompted this letter. Section 15 provides for extinguishment of the charge in two circumstances - where the claim relates to retention moneys only, if no action is brought within four months after the retention moneys become payable; and in other cases, where no action is brought within two months after notice of claim of charge. On 11th December, the solicitors for the appellant wrote to the Crown Solicitor asserting (apparently incorrectly) that s.15 would not extinguish this charge because it related to retention moneys. Enquiry was also made as to the date of payment of any such moneys, "as we must commence any action in respect thereof within four months of the date of such payment." See ex. 20.

On 11th January, 1991 the Crown Solicitor replied, suggesting that as the claim related to all moneys rather than to retention moneys, s.15(10(b) applied, with the shorter time limitation therein prescribed. On January 21st, 1991, the solicitors for the appellant wrote inquiring, "if you hold any retention money which is or could be deemed the subject of our charge." The next letter is a letter dated 7th February, 1992 from the Crown Solicitor to Messrs Steindl Robertson McPherson,

apparently now acting as solicitors for the appellant, referring to, "your letter dated 22nd January, 1992". The letter otherwise confirmed that although the sum of $52,277 had been retained until the charge lapsed, it had subsequently been disbursed to Barclay Mowlem Construction Limited on 31st January, 1991. It was not submitted that any charge had survived in these circumstances.

Of course, in proceedings to enforce the charge, it would have been necessary to address the question of whether Barclay Mowlem was indebted in any amount to Delahunty Air Conditioning. Section 5(3) of the Act limits the amount recoverable under such charges of subcontractors to the amount payable to the relevant contractor. Although a considerable part of this short trial was spent on that issue, it was not ventilated fully. Barclay Mowlem had claimed that Delahunty Air Conditioning owed it money. This claim allegedly arose out of the cost of completing the job after Delahunty Air Conditioning collapsed. (See ex. 31.) That exhibit was not received as proof of its contents but only of the fact that Barclay Mowlem was so claiming. See p. 18 in the evidence of the witness, Swift, an employee of the liquidators of Delahunty Air Conditioning.

Swift also testified that he understood from the respondent that Barclay Mowlem was indebted to Delahunty Air Conditioning in the sum of $395,402.72. The liquidators made no attempt to recover this amount, presumably because of the opinion reflected in ex. 29, the liquidators' report, (at p. 91

of the record) concerning the cost of completing outstanding work when a contractor goes into liquidation. In other words, it seems that the liquidators chose not to enforce the claim against Barclay Mowlem because of a belief that such company had a substantial cross-claim, although the evidence does not reveal any investigation of the merits thereof.

Exhibit 32 contains two documents, each of which purports to show that a sum (in one case, $235,005.20 and in the other, $237,332.90) was owing to Delahunty Air Conditioning by Barclay Mowlem. These calculations were received as evidence of their truth, being matters within the respondent's knowledge. See p. 22, ll 38-40 and pp. 23-26. They take account of the cost of completing the work, although the figure used is the remaining value of the contract after estimation of the value of all work performed By Delahunty Air Conditioning. Thus the calculations fail to take into account the possibility that another contractor might have charged a greater amount to complete the project. Unfortunately, there was no other evidence on this point. The appellant's only contribution was evidence that a cross-claim had been made by Barclay Mowlem without any attempt to justify it and without evidence of any investigation. I should add that although the liquidators knew of the cross-claim, there was no evidence that the appellant was so aware at any material time.

The cross-claim is important for two reasons. Firstly, the charge would only have had value to the respondent if there were

a debt owed by Barclay Mowlem to Delahunty Air Conditioning. The virtually unchallenged evidence of the respondent was that a net sum of over $235,000 was so owed, making some allowance for the cross-claim. Even allowing for the possibility that the cost of completing the project (i.e. the amount of the cross-claim) might have been greater than the amount allowed by the respondent, on the evidence, Barclay Mowlem was probably indebted to Delahunty Air Conditioning in an amount exceeding that claimed by the appellant from the respondent. The learned trial judge found that the debt was $235,005.20 (See p. 103.) There was no challenge to this finding.

At the trial, the parties concentrated their attention upon the charge against funds held by the Crown Solicitor rather than that against funds still owing by Barclay Mowlem. It may have been thought by the respondent that this would avoid the thorny problem of the cross-claim. I doubt that such was the case. Section 5(3) of the Act seems to limit the amount recoverable by the respondent and any other sub-contractors pursuant to the charge to the amount payable by Barclay Mowlem to Delahunty Air Conditioning. However this point was not argued before us, and I need not take it further.

The second aspect of the case to which the cross-claim relates is the reasonableness of the appellant's conduct in not seeking to enforce the charge. The creditor's duty would only compel it to enforce the charge if the chances of deriving a substantial benefit were good. This would involve an assessment

of the prospects of the cross-claim and the cost of enforcing it. However the evidence establishes that the charge lapsed because of a mistake by the appellant's solicitors rather than as a result of any decision by the appellant as to prospects of success. There can be no other explanation of the correspondence, and in particular exs. 20, 21, 22 and 23. Mr Staley, a director of the appellant said in evidence at p. 12 that he made decisions with respect to the claim of charge, including the decision not to proceed with it. He said that his decisions were based upon advice received from his solicitors. Whatever that may mean, it does not undermine the inference that the proceedings failed, not because of any commercial judgment on the part of the appellant, but rather because the appellant's solicitors misunderstood the law. If the appellant did not know of the cross-claim, then there was no reason not to prosecute the claim of charge. If the appellant knew of the cross-claim, then a decision should have been made as to whether to enforce it, based upon known facts. Neither course was taken.

Counsel for the appellant sought to characterize the appellant's action in not commencing an action as being akin to choosing not to enforce a security, relying upon the various cases which suggest that a creditor is not obliged to enforce his charge at any particular time. However, commencing an action to enforce a charge under this Act has the additional significance of extending the duration of the charge, effectively until the resolution of the action. Commencement of

action is as much a step taken to protect the charge as it is a step towards its enforcement. Reverting to the language of Dixon J in Williams v Frayne, the appellant was obliged to take reasonable care to ensure that the benefit of the charge should not be lost. The extent of that duty must be determined by reference to all the surrounding circumstances and not by reference to an artificial generalization masquerading as a rule of law.

Relevant circumstances included the fact that notice had been given, that the respondent had suggested that such a charge be claimed, and that sufficient moneys were owing to Barclay Mowlem by the Crown and were being held subject to the charge. The appellant was in a position to provide sufficient information about the claim to acquire the engineer's certification which appears on the notice. The appellant had the benefit of the liquidators' report, ex. 29, dated 9th July, 1990. The cross-claim by Barclay Mowlem was also relevant, at least if the appellant knew of it.

Having made a claim, the appellant was obliged to act reasonably to preserve it. That the next step in discharging such obligation involved the commencement of proceedings does not, to my mind, lead automatically to the conclusion that such step need not have been taken. It would have been appropriate to enquire into the cost of commencing the action and the risks involved, including the exposure in costs. If the prospects were doubtful or the amount necessary to prosecute the action

great, then a decision not to proceed might have been justified. In the present case, however, the appellant did not decline to proceed with the action for any such reason but rather because of a misunderstanding of the obligations imposed by the Act. Clearly, the loss of the charge was attributable solely to this error.

I do not suggest that the only appropriate step to discharge the appellant's duty was to commence and prosecute an action. It may have been sufficient to notify the respondent timeously of the intention not to proceed to enforce the charge, extending to him the opportunity of doing so upon appropriate conditions. However this step was not taken. Before us, although not at the trial, it was suggested that the respondent should have paid out the debt and himself sued to enforce the charge. That is no answer to the respondent's case. It is the appellant's conduct which is in issue. The question is whether it was reasonable to abandon the charge without giving notice to the respondent of the intention to do so. The evidence does not establish that the latter knew that notice of claim of charge had been given. He certainly was not told that the appellant intended to abandon it, for such was not the appellant's intention. As far as the evidence goes, the appellant intended to enforce the charge, but mistook the relevant procedure.

As I have previously pointed out, the cases do not generally support the proposition that a surety's entitlement to pro tanto reduction for loss of security only arises upon

discharge of his obligation as surety, nor is there support for the proposition that the creditor's duty to protect securities is discharged if the surety does not pay out the debt and himself protect them. If either proposition were valid, there would be little or no room for the operation of this equitable principle. Although in considering the reasonableness of the creditor's conduct, the conduct of the surety may be a relevant factor, it is only one such factor. When, as here, the creditor has claimed the security, it will be a risky course to allow the security to lapse without giving express notice to the surety.

In many cases, it will be the failure to give notice rather than the abandonment of the security upon which the surety will rely, but that was not the case here. The charge was lost because of the respondent's conduct, based upon a mistake of law. No question of giving notice arose because the respondent always intended to enforce the charge, at least until after it had lapsed. The operative neglect was the failure to enforce the charge.

The learned trial Judge concluded that there had been a deliberate choice not to pursue the charge, which choice led to its extinguishment. His Honour said that such conduct was not evidence of, "male fide neglect, default or negligence as contemplated by the authorities", and that, "the plaintiff has, although by no negligence, neglect or default nonetheless wasted the security." (See p. 106.) It is difficult to understand his Honour's meaning. The test prescribed by Brennan J in

Buckeridge (supra) requires neglect or default to be proven. This implies a duty to act which has not been discharged. Such a duty will arise from the circumstances of the case and is to be measured in accordance with the test of reasonableness prescribed by Dixon J. Whatever the learned trial Judge meant, it is impossible in this case to characterize the failure to commence action as other than a breach of that duty. Even if the appellant tried to justify its inactivity by reference to the prospects of success in light of the cross-claim, that argument could not be successful on the evidence as it stood in this case. There were excellent prospects of success and no suggestion that the action would be costly.

If the alternative course of "assigning" the action to the respondent had been followed, there was no reason to believe that he would not have been able to fund it, given the probability of success. It is true that in the appellant's cross-examination of the respondent this passage appears at p. 33 of the record:-

> "You would take dispute with (the claim by Barclay Mowlem), but you are aware of the allegation of that effect by Barclay Mowlem? -- Yes.
>
> You weren't in any position to take any action against them? -- No."

If this meant that the respondent was not in a financial position to pursue any proceedings against Barclay Mowlem, then it would be evidence suggesting that he could not have taken advantage of such an "assignment" and that therefore he did not suffer loss as a result of the appellant's failure to notify him

of its intention to abandon the charge. However I do think that so much can be made of it, and no such suggestion was made at the trial or before us. Once again, the issue appears to have gone by default. In the absence of evidence to the contrary, there was no reason to believe that the respondent would not have been able to raise sufficient funds to allow the action to proceed.

An alternative argument advanced by the appellant was that no equitable relationship arose between the parties for some reason peculiar to the nature of this charge. I have no doubt that a charge under the Act is a security for the purposes of the equitable rule with which I am here concerned. I cannot understand the basis upon which it is asserted that an equitable relationship was not created. The thrust of the cases is that the relationship of creditor and surety of itself confers upon the surety an entitlement to the benefit of all securities held by the creditor. Once that relationship is established, equity will intervene where the creditor's conduct in respect of any security falls short of the level prescribed. The charge in question was, in reality, over money payable to Delahunty Air Conditioning, the debtor. It secured payment of the debt owed by that company to the appellant. I can see no reason to treat it as other than a charge for present purposes merely because it was created by statute and not by the act of the debtor.

The effect of the appellant's breach of duty was loss of the security by effluxion of time, depriving the respondent of

its value. He was therefore entitled to pro tanto reduction of his indebtedness to the appellant. His Honour's finding that $235,005.20 was owed to Delahunty Air Conditioning by Barclay Mowlem and the amount held by the Crown Solicitor show that in any action to enforce the charge, the appellant (or the respondent by subrogation) would have been successful in an amount equal to the present claim. There was no evidence that the interests of other sub-contractors would have affected the position.

The effect of the appellant's breach was to reduce the amount of the respondent's liability to the appellant by the amount of the lost security. The amount of the claim in this action was $52,227 and interest. In fact, the amount initially claimed from the guarantor prior to action was $50,706. The amount claimed pursuant to the Act was $50,706 plus a further $1,571, giving the total of $52,277. This sum was retained by the Crown and would have been available in reduction of the debt. With the exception of the claim for interest, the effect of the pro tanto reduction was to reduce the claim against the respondent to nil. As to the question of interest, the claim was pursuant to the Common Law Practice Act and was therefore in the discretion of the Court. Because of the way in which the case was decided, that discretion was never exercised, but it is unlikely that any such claim would have been successful in view of the absence of any principal sum.

In the circumstances, I consider that the judgment below

was correct. I would dismiss the appeal with costs.