

## Case Note

### ***Bofinger v Kingsway Group Limited*** (2009) 239 CLR 269

by



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***Bofinger v Kingsway Group Limited*** (2009) 239 CLR 269; [2009] HCA 44  
(Gummow, Hayne, Heydon, Kiefel and Bell JJ)

This High Court case relates to the equitable principle of subrogation. It is a significant decision. The case provides much needed clarification as to whether a surety has priority, as against later registered mortgagees, in the distribution of the surplus of proceeds. In a joint judgment of the Court, the appellants were successful having failed at both first instance and on appeal to the New South Wales Court of Appeal.

The Court was also clear in sounding a warning to appellate courts to restrain any show of amenability to the recent line of English authorities in relation to the characterisation of equitable doctrines.

#### *Facts*

The parties proceeded by way of an agreed statement of facts.

The appellants (**Bofingers**) were a married couple and directors of a company in liquidation (**B&B Holdings**). The respondents were in five camps. Three groups of respondents represented respectively the interests of the first, second and third mortgagees of land owned by B&B Holdings and sold by the first mortgagee. The fourth group represented the solicitors acting for the first, second and third mortgagees. The fifth group of respondents were the liquidators of B&B Holdings who, along with the third mortgagee, entered submitting appearances.

Prior to the sale of the B&B Holdings land, the Bofingers had paid in full their liability to the first mortgagee under their guarantees for the indebtedness of B&B Holdings. The Bofingers were able to make this payment by selling their own land which had also been provided by them as security to the first, second and third mortgagees to support the Bofingers' guarantees to them for the debts of B&B Holdings.

Upon the sale of the B&B Holdings land the first mortgagee took from the proceeds such moneys as were necessary to satisfy the balance of the debt of B&B Holdings to it and then paid the net surplus to the second mortgagee.

### *The Arguments of the Parties*

The Bofingers claimed they were entitled to the surplus in priority to the second mortgagee. They asserted that as a surety of B&B Holdings they were subrogated to the rights of the first mortgagee under the first mortgage to recover their contribution to the reduction of the debt of B&B Holdings to the first mortgagee, that is, "subrogation in aid of the surety". The Bofingers claimed that the surplus in the hands of the first mortgagee had been paid to the second mortgagee in breach of trust. They claimed the surplus in the hands of the second mortgagee was held by it on trust for them and that in so far as the solicitors for the second mortgagee had received such moneys from the second mortgagee, they were accountable to the Bofingers [38].

The first mortgagee and the second mortgagee adopted a unified response. They asserted that [43]:

- any charge in favour of the Bofingers that may have existed over the surplus in the hands of the first mortgagee was lost upon payment to the second mortgagee;
- even if the charge survived the transmission of moneys from the first mortgagee to the second mortgagee, it was a security interest only and did not give rise to a trust in the hands of the first mortgagee and therefore did not support a proprietary interest against the second mortgagee;
- once the discharges of mortgage had been delivered to the second mortgagee with the cash surplus any such charge would be extinguished.

The Court held that all of these matters did not require resolution to determine whether the Bofingers could make out their claim. It held that the task was to identify the scope of the equitable relief and whether it was available in the circumstances that prevailed on the date that the first mortgagee held a surplus in relation to the sale of the B&B Holdings land [45].

Drawing on authorities which hold that a second mortgagee must await the utilisation of the first mortgagee's security by a surety of the debt to the first mortgagee, the Court held that the Bofingers were entitled to the relief claimed by them. The Court followed *Drew v Lockett* [1863] EngR 589 where it was held that a second mortgagee took its interest knowing there was a prior charge on the property and that the amount so secured was limited therefore "*it is a matter of indifference whether the first mortgagee or the surety was the prior claimant for the amount*" [9] - [10].

The notion that the principal debtor had ultimate liability for the indebtedness the subject of the guarantee was the foundation for the application of subrogation in aid of the surety [8].

The respondents further argued that even if the circumstances permitted equity to assist the Bofingers, by the terms of their guarantees to the second mortgagee they had agreed to exclude themselves from relying on such relief, or by reason of their conduct, it would therefore be inequitable for them to claim entitlement to the surplus.

With regard to this last point the second mortgagee relied on a clause of the Bofingers guarantees' to it which provided that the Bofingers "*waived their rights as surety whether legal, equitable, statutory or otherwise which may be inconsistent with the provisions of this deed or in any way restrict the Lender's rights, remedies or recourse*". The Court held that this term could not be relied on to exclude the Bofingers' right to subrogation in aid of their suretyship because the right to subrogation arose under the guarantee and mortgage of the first mortgagee whereas the term was referable to and excluded only those rights available to the Bofingers under the guarantee to the second mortgagee [59]. The Court also rejected a number of other arguments put for the second mortgagee regarding the construction of its guarantee [53] - [68].

#### *Decision of Court of Appeal*

The members of the Court of Appeal had not given uniform reasons for upholding the decision of the trial judge. Giles JA had taken the view that the giving of guarantees and mortgages by the Bofingers to the second mortgagee and the third mortgagee was assuming an obligation which was inconsistent with the assertion of a prior entitlement to subrogation. The Court held that the terms of the second guarantee had manifested no such intention to assume such obligations and each guarantee operated in accordance with its terms [70] - [71].

Handley JA considered that the Bofingers were prevented from claiming the surplus in priority to the second and third mortgagees by estoppel by convention. His

Honour was concerned that by paying off the debt secured by the first mortgage, the first mortgagee could keep the mortgage alive for its own benefit in order to satisfy its obligations to a surety. Estoppel by convention was made out, not on a representation of facts by a party to the detriment of the other party, but rather, conduct of the parties based on a shared understanding of facts which both will be estopped from denying. The Court held that the agreed facts fell far short of establishing the understanding necessary to found the estoppel [75].

Handley JA also raised the rule in *Otter v Lord Vaux* [1856] EngR 694 that concerns the rule of merger of charges in estates. The Court held the rule did not apply to mortgages registered on Torrens title as these were statutory charges [76]. The rule provides that whenever a greater and lesser estate meet in the same person, without any intermediate estate, the lesser is merged in the greater estate unless there is an intention there be no such merger. The effect of the rule is that a mortgagor who has paid off a first mortgage cannot set up the first mortgage in priority to a later mortgage [77].

Sackville AJA determined the appeal on the basis that it was not unconscionable for the first mortgagee to account to the second mortgagee for the surplus [78]. The Court held that this approach could not withstand the operation of a first principle, namely, that in equity, as was clearly stated in *Drew v Lockett*, the first mortgagee was obliged to account to the Bofingers for the net surplus. Sackville AJA considered that the arrangements were plainly not intended to permit an opportunity whereby the second mortgagee was transformed from a secured creditor to an unsecured creditor. The Court took the view that when the Bofingers sold their own properties, the second mortgagee and third mortgagee had permitted them to give clear title to the purchaser without first requiring that the Bofingers and the first mortgagee agree with the second mortgagee and the third mortgagee that the Bofingers right to subrogation would not take priority to their interests upon the sale of the B&B Holdings land [80].

The Court compared the equitable doctrine of subrogation with that of unjust enrichment and was careful to emphasise, in keeping with its current approach to all matters touching on equitable principles, that these principles remain rooted in a “taxonomy” which, imperfect though it might be, defies treatment at the indelicate hands of the unifiers. The Court restated the Australian position that unjust enrichment was a merely a concept and not a “unifying legal concept” [86]. The concept may be used to compare and contrast various categories of liability. Subrogation may have the

effect of preventing unjust enrichment of the principal debtor, however, “*the two doctrines have different foundations in equity and operate with different results*” [88].

The Court said of the various applications of the equitable doctrine of subrogation:

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

The Court referred to a statement by Giles JA in which he stated that by reason of recent English decisions the doctrinal basis of subrogation was “*open to debate*”. The Court countered by stating that the Australian law on the subject “*is not unsettled*” and that the respondents had correctly declined to put any argument in support of the view expressed by Giles JA [98].

The Court held that in the absence of any prior consent or release that the amount of the surplus in the hands of the first mortgagee had been held by it as a constructive trustee for the Bofingers and that it was obliged to account for the amount of the surplus to the Bofingers as such and was liable to pay equitable compensation to them in the nature of interest [99].

*Other observations by the Court*

- A claim founded in the equitable right of subrogation is not a “cause of action” [6].
- The application of the doctrine of subrogation did not do violence to the Torrens system – it enforces upon registered proprietors conscientious obligations imposed upon them [12].
- The charge or equitable lien arising under the right of subrogation would support a caveat [12].
- The facts might have supported a claim against the second mortgagee for moneys had and received but such a claim was not argued by the appellants [43].