Privy Council Appeal No. 42 of 1984

Scholefield Goodman and Sons Limited *Appellant*

v.

(1) Charna Zyngier and *Respondents*
(2) Westpac Banking Corporation

FROM

THE FULL COURT OF THE SUPREME COURT OF VICTORIA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 16TH AUGUST 1985

Present at the Hearing:

LORD KEITH OF KINKEL
LORD ROSKILL
LORD BRIGHTMAN
LORD GRIFFITHS
SIR OWEN WOODHOUSE

*[Delivered by **Lord Brightman**]*

This is an appeal from a decision of the Full Court of the Supreme Court of Victoria concerning the right of the drawer of a dishonoured bill of exchange to demand contribution from a third party who gave security to the bank discounting the bill. The trial judge found against the drawer, as did the Full Court. The drawer now appeals to Her Majesty in Council with the leave of the Full Court.

Zinaldi and Company Pty Limited ("Zinaldi"), a company incorporated in the State of Victoria, was a customer of the Commercial Bank of Australia Limited, now Westpac Banking Corporation ("the Bank"), who are the second respondents. On 6th February 1976 Mrs. Zyngier, the first respondent, executed in favour of the Bank a mortgage of certain land of which she was the proprietor. The instrument of mortgage was a document of great length and complexity, but for present purposes it can be summarised as follows. Mrs. Zyngier, in consideration of advances and accommodation granted by the Bank to her or to
[31] Zinaldi, covenanted with the Bank as follows:-

"To pay to the Bank on Demand ... the balance for the time being owing by Mrs. Zyngier to the Bank on the account current of Mrs. Zyngier with the Bank or by Zinaldi on the account current of Zinaldi with the Bank and all ... other ... sums ... which the Bank may ... advance ... to ... Mrs. Zyngier or Zinaldi ... or which now are or may hereafter become owing from or payable by Mrs. Zyngier or Zinaldi

(a) for or in respect of any moneys which may be payable by Mrs. Zyngier or Zinaldi to the Bank either solely or jointly with any other person under any contract or any other account whatsoever whether the time or respective times for the repayment thereof have arrived or not or

(b) for or in respect of any bills of exchange or promissory notes to which Mrs. Zyngier or Zinaldi is or may hereafter be a party and on which Mrs. Zyngier or Zinaldi is or may hereafter be liable (solely or jointly with any other person) either primarily or only in the event of any other person failing to duly pay the same which are or may hereafter be discounted or paid or which may for the time being be held by the Bank ..."

Put at its shortest, Mrs. Zyngier agreed to pay the Bank the balance for the time being owing on her own current account and on Zinaldi's current account, and all other sums owing by her or by Zinaldi, including any sums owing (primarily or secondarily) in respect of bills of exchange discounted by the Bank. In setting out the terms of the mortgage their Lordships have endeavoured to make the document more readable by division into sub-clauses, by substituting Mrs. Zyngier and Zinaldi for "mortgagor" and "debtor", and by substituting "or" for numerous "and/or's". Clause 5 conferred a power of sale over the mortgaged premises.

Between August and November 1976 the appellant Scholefield Goodman & Sons Limited ("Scholefield"), a company incorporated in the United Kingdom, drew five bills of exchange totalling about £20,870 sterling on Zinaldi payable to the order of the Bank. The purpose of the bills was to finance the import of goods by Zinaldi. The bills, which were payable three months or more after date, were accepted by Zinaldi. Each bill was delivered to and discounted by the Bank, which accordingly became the holder thereof, the discounted value of the bill being paid to Zinaldi. The bills matured on various dates in January 1977, but were all dishonoured by Zinaldi. The Bank then presented the bills to Scholefield as drawer, which paid the Bank the amounts due.

On 16th August 1978 the Bank called upon Mrs. Zyngier under the mortgage to discharge Zinaldi's overdraft, which then amounted to about $20,000 in Australian currency. This figure did not of course include the money due on the dishonoured bills, since this had been paid by Scholefield. On 23rd August Mrs. Zyngier paid off Zinaldi's overdraft and asked the Bank to discharge the mortgage. On 1st September the Bank's solicitors wrote to Mrs. Zyngier's solicitors stating that their clients were unable to comply with such request by reason of claims advanced by Scholefield. It transpired that Scholefield was claiming equal contribution from Mrs. Zyngier on the basis that they were co-sureties, and was also claiming to be subrogated to the rights of the Bank as mortgagee in order to secure payment of the contribution claimed. The rationale of Scholefield's claim is set out in paragraph 20 of its printed case, as follows:-

> "When each of the bills involved in this case was dishonoured by the acceptor, Zinaldi, we submit that the Bank had a choice. It could have made a demand upon Mrs. Zyngier under the mortgage. If that demand was not met then the Bank could have obtained payment out of the proceeds of the sale of the mortgaged property. Alternatively it could have demanded payment from Scholefield as the drawer. The Bank could have resorted to either of them indifferently. The central question then upon this appeal is whether the Bank by choosing to look to, and obtain payment from, Scholefield can throw the whole of the liability upon Scholefield. In our submission it would be inequitable to allow the choice of the creditor to determine the matter. The doctrine of contribution is designed to equitably apportion the loss in such a situation."

At first sight Scholefield's claim is a surprising one; for if Mrs. Zyngier had taken over the bills from the Bank, she as holder could have demanded payment from Scholefield as drawer, and it is not immediately apparent on what ground Scholefield could have resisted payment. This suggests that there may be an underlying fallacy in Scholefield's claim.

Mrs. Zyngier issued proceedings against the Bank and Scholefield claiming a declaration that Scholefield was not entitled to contribution from her, and an order on the Bank to discharge the mortgage. Scholefield counterclaimed that it was entitled to contribution from Mrs. Zyngier, and to an assignment of the mortgaged premises as security for the contribution due.

Their Lordships turn to the relevant statutes. The respective liabilities of drawer, indorser and

acceptor of a bill of exchange are regulated in the State of Victoria by the Australian Bills of Exchange Act 1909-1973:-

"59. The acceptor of a bill, by accepting it -

(a) engages that he will pay it according to the tenor of his acceptance; ...

60.(1) The drawer of a bill, by drawing it -

(a) engages that on due presentment it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder or any indorser who is compelled to pay it ...

(2) The indorser of a bill, by indorsing it -

(a) engages that on due presentment it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder or a subsequent indorser who is compelled to pay it ..."

Rights of subrogation are regulated by section 72 of the Victoria Supreme Court Act 1958, which so far as relevant for present purposes provides as follows:-

"Every person who being surety for the debt ... of another or being liable with another for any debt ... pays such debt ... shall be entitled to have assigned to him or to a trustee for him every ... security which is held by the creditor in respect of such debt ... and such person shall be entitled to stand in the place of the creditor ... in order to obtain from ... any co-surety ... or co-debtor ... indemnification for the ... loss sustained by the person who has so paid such debt: ... Provided always that no co-surety ... or co-debtor shall be entitled to recover from any other co-surety ... or co-debtor by the means aforesaid more than the just proportion to which, as between those parties themselves, such last-named person is justly liable."

The action came to trial before His Honour Mr. Justice O'Bryan on an agreed statement of facts. The learned judge made the declaration and order sought by Mrs. Zyngier, on the ground that the liability of Scholefield on the bills and the liability of Mrs. Zyngier under the mortgage were not such co-ordinate liabilities as would attract the principles of contribution. The liability of Scholefield to the Bank arose under section 60(1)(a) of the Bills of Exchange Act 1909-1973 when the bills were dishonoured. The liability of Mrs. Zyngier under the mortgage did not arise until a demand was made on her to discharge the whole balance due on the Zinaldi account, which might or might not include the sums

due from Zinaldi as acceptor of the bills; the Bank had no direct recourse against Mrs. Zyngier on the bills; the liabilities of Mrs. Zyngier and Scholefield were not of equal status, and they were not co-sureties for the purpose of the doctrine of contribution.

On appeal, the Full Court reached the same conclusion. In his judgment, with which the other members of the Court agreed, the Honourable Mr. Justice Fullagar said this:-

> "... Mrs. Zyngier was a surety for the performance of their duties as surety of all persons liable on the bills; that is to say, she was a surety in a different degree from the suretyship of the drawer Scholefield and, if Mrs. Zyngier had paid the full amount of the ultimate balance owing on general account to the Bank, and that general ultimate balance had included the amount of the relevant bills of exchange, she then would have been entitled not to contribution but to indemnity from the parties otherwise liable on the bill and thus from Scholefield...."

> "... I am of opinion that, upon the proper construction of the mortgage instrument, Mrs. Zyngier became a surety to the Bank for the performance of their obligation by (amongst others) all persons who were liable on the bills of exchange. In other words, to use the words of Masten, J.A. in the Canadian case earlier cited [*Molsons Bank v. Kovinsky* [1924] 4 D.L.R. 330], I think the true construction of the document is such as to make Mrs. Zyngier, as against Scholefield, not a co-surety but a surety for a surety."

The right of one of two or more sureties to contribution from a co-surety is founded upon equitable principles, and exists independently of whether the sureties are bound by the same or different instruments, and whether one surety became bound with or without the knowledge of his co-sureties.

> "The principle of Equity operates ... upon the maxim, that equality is Equity: the creditor, who can call upon all, shall not be at liberty to fix one with payment of the whole debt; and upon the principle, requiring him to do justice, if he will not, the Court will do it for him;" (per Lord Eldon L.C. in *Craythorne v. Swinburne* (1807) 14 Ves. 160 at page 165.).

The Lord Chancellor returned to the case six days later, and added this (at page 171):-

> "... all sureties are equally liable to the creditor; and it does not rest with him to determine, upon whom the burthen shall be thrown exclusively ... if he will not make them contribute equally, this court will finally by arrangement secure that object."

In *Craythorne v. Swinburne* two bonds had been given to a bank to raise money to discharge the debts of Henry Swinburne. The first bond was executed by Henry Swinburne as principal and by Craythorne as surety for the sum of £1200. The other bond was executed by Sir John Swinburne. It recited the first bond, and was conditioned to be void on payment by Henry Swinburne and Craythorne or either of them. After the death of Henry Swinburne insolvent, Craythorne was called upon to pay the whole sum due. He sought contribution from Sir John Swinburne. Sir John claimed that he was not a co-surety for Henry Swinburne, but that his bond was merely a collateral security for the bank in default of payment by both Henry Swinburne and Craythorne. Lord Eldon decided in favour of Sir John Swinburne. The reasoning was that a surety may by his contract limit his liability in any way he pleases.

> "A party may take care by his engagement, that he shall be bound only to a certain extent ... If therefore by his contract a party may exempt himself from the liability, or that extent of liability, in which without a special engagement he would be involved, it seems to follow, that he may by special engagement contract so as not to be liable in any degree. That leads to the true ground, the intention of the party to be bound, whether as a co-surety; or only if the other does not pay." (At pages 169, 170).

It was therefore simply a question of the true construction of the second bond - the proper interpretation of the bargain struck between the Bank and Sir John in the light of admissible evidence of surrounding circumstances - whether Sir John had thereby constituted himself a co-surety for Henry Swinburne, so as to stand on an equal footing with Craythorne, or whether he made himself liable only upon default by Henry Swinburne and Craythorne if neither should pay. The latter was held to be the true construction of Sir John's bond.

In *Craythorne v. Swinburne* Lord Eldon drew upon *Dering v. Earl of Winchelsea* (1787) 1 Cox. 318, which had been decided in the Exchequer some twenty years earlier and in which Lord Eldon had himself appeared as counsel. It was there said that the right of contribution "... is bottomed and fixed on general principles of justice, and does not spring from contract; though contract may qualify it". The

meaning of that passage is that the right of contribution arises between two or more persons who are sureties for the same debt, regardless of whether there is any contract conferring such right, because the right is not founded upon contract; but "contract may qualify it" in the sense that a contract of suretyship may be so worded, in a case where there is another surety, as to restrict the scope of the suretyship to default both by the debtor and by such other surety; in such a case the terms of the contract of suretyship inevitably preclude contribution.

> "A person may take himself entirely out of the principle, as where he becomes merely a collateral security, by limiting his liability to payment of the debt upon the default of the principal and other sureties".

White and Tudor leading cases in Equity, 9th edition, 2,page 500.

In Re Denton's Estate [1904] 2 Ch. 178 is an illustration of circumstances in which the English Court of Appeal applied the principle of *Craythorne v. Swinburne*. The lessee of a public house mortgaged it to a bank to secure a loan, Denton joining as surety. As additional security there was effected with an insurance company a "mortgage insurance policy" whereby the insurance company guaranteed the mortgage debt. The leaseholder defaulted, and a deficiency arose on realisation of the mortgaged premises. Swinfen Eady J. held that the estate of Denton, who had died, was entitled to contribution as against the insurance company. The Court of Appeal reversed the decision, holding that the true meaning of the parties to the transaction was, not that the insurance company was a co-surety with Denton, but that, as between the insurance company and the bank, Denton was in the position of a principal "or, in other words, that the transaction was of the same nature as that which was the subject of decision in *Craythorne v. Swinburne*" (per Stirling LJ. at page 193).

Cornfoot v. Holdenson [1932] V.L.R. 4 is an example of the converse case. Holdenson had guaranteed the debtor's account at his bank up to £3,000 and interest. Four months later Cornfoot by a separate and independent document, not referring to the earlier one, guaranteed the same account up to £2,000 and interest. On the insolvency of the debtor, the bank called upon the two guarantors to discharge the debt, which amounted to about £3,500. Cornfoot paid his full liability of £2,300 and Holdenson paid the balance of £1,200. Cornfoot then claimed contribution from Holdenson. Mann J. said, in the opinion of their Lordships correctly, that:-

> "It must remain always a matter of construction of the contracts in question as to whether the guarantors are sureties for separate independent debts or not, and I can find nothing whatever in the circumstances of this case to suggest that the contracts are anything except guarantees in respect of the whole floating balance for principal and interest of the debtor, with a definite limit on the amount of liability of each guarantor."

Contribution was decreed accordingly.

Much of the argument before their Lordships centred on the decision of the House of Lords in *Duncan Fox & Co. v. The North and South Wales Bank* (1880) 6 App. Cas. 1, which bears a superficial resemblance to the present case. Radford, who traded in partnership, deposited deeds with the bank at the request of his firm to secure payment on the bills of his firm which the bank discounted. Duncan Fox & Co., who were unpaid vendors, indorsed in favour of the bank bills which had been accepted by the Radford firm, and the bank discounted the bills for the benefit of Duncan Fox & Co. The Radford firm stopped payment, and the bills were dishonoured. The bank demanded payment from Duncan Fox as indorsers. Duncan Fox, being as between themselves and the bank sureties on the dishonoured bills, claimed to be entitled to the indemnity afforded by the deeds which Radford had deposited as security. At the time when the question arose, all dealings and accounts between the Radford firm and the bank had been closed, and nothing remained due to the Bank except the unpaid balance on the bills. Duncan Fox did not dispute their liability to the bank, but claimed that upon payment they would be entitled to the Bank's security. The claim succeeded. The basis of the decision was that as a drawer or indorser who is compelled by the holder to pay has recourse against the defaulting acceptor, it logically follows that he also has recourse against securities deposited by the defaulting acceptor with the holder. The proposition established by that case is correctly stated in *Commissioners of State Savings Bank of Victoria v. Patrick Intermarine Acceptances Limited* [1981] 1 NSWLR 175, at page 180:-

> "If the indorser of a bill pays the holder of it he is entitled to the benefit of the securities given by the acceptor which the holder has in his hands at the time of payment, and upon which he has no claim except for the bill itself."

The words "given by the acceptor" are essential to the proposition. It is also essential to the proposition that the holder has no further interest in the securities, e.g. the indorser could not call

for the securities if the holder were a Bank and the securities were pledged to secure other undischarged obligations of the acceptor to the bank, as in *Dalgety Limited v. Commercial Bank of Australia Ltd* [1981] 2 NSWLR 211.

The principle established in the *Duncan Fox* case has no direct application to the present appeal. Mrs. Zyngier is not the equivalent of Radford, because Mrs. Zyngier was not a party to the bills. Radford on the other hand was one of the acceptors and therefore primarily liable on the bills. Radford and his partners (as acceptors) owed money to the bank and had lodged security. Duncan Fox (as indorsers) had promised to pay if the Radford firm did not. The bank could have resorted to the mortgaged premises for payment, being security lodged by the principal debtors. Instead the bank claimed from Duncan Fox, who were in the position of sureties. Therefore Duncan Fox on paying the debt were entitled to be subrogated to the bank's remedies against the Radford firm, which included the security lodged by Radford. The headnote to the case accurately summarises the principle, "The indorser is a surety for the payment to the holder, and, having paid it, is entitled to the benefit of any securities to cover it deposited with the holder by the acceptor".

The fundamental question in the present case, therefore, is whether upon the true construction of the bargain between the Bank and Mrs. Zyngier, Mrs. Zyngier placed herself, as regards bills of exchange accepted by Zinaldi and thereafter dishonoured, in the position of a co-surety alongside the drawer or indorser; or whether, upon the true construction of the bargain, her liability to the Bank upon a bill was intended to be limited to a case of default by the parties liable upon the bill. If it were the true meaning of the mortgage that the Bank was required to call upon the parties to the bill before it called upon Mrs. Zyngier to make good a default, then *ex hypothesi* no injustice ensued to the drawer upon the Bank's adoption of that course and no case for the intervention of a court of equity could arise.

If a third party (in the instant case Mrs. Zyngier) guarantees a bill of exchange for the benefit of a bank which discounts it, the normal understanding will be that the surety guarantees that payment will be made by one or other of the parties to the bill who are liable upon it, whether as acceptor or drawer or indorser. It will not be the normal understanding that the surety intends to place himself on a level with the drawer, so as to be answerable equally with the drawer if the acceptor defaults. There is no reason why he should. There

is no reason to suppose that, in a contract between the bank and the surety, the surety desires to confer a benefit on the drawer and to share with him the responsibility for a dishonoured acceptance. Nor is there any reason why the bank should wish to call upon the surety for payment until the parties to the bill have defaulted. As their Lordships have indicated, and as is apparent from *Craythorne v. Swinburne*, the claim to contribution against a surety must depend upon the true construction of the contract which created the suretyship, because the surety can by such contract limit the scope of his suretyship to whatever extent he pleases. Contribution is founded on the principle that equality is equity, and there is no room for the application of this doctrine unless the surety against whom contribution is claimed has placed himself on the same level of liability as the surety who claims contribution from him. It would be possible for a bank guarantee to be so worded that the surety deliberately places himself upon an equal footing with the drawer or indorser of the bill discounted by the bank, but it would produce an irrational result. It is not a construction to be adopted unless the intention is clear, because there is no reason why the bank and the third party who gives the guarantee to the bank should have such an intention. In the instant case there is no such clear intention. There was no reason why Mrs. Zyngier should voluntarily share the burden of the drawer, and no reason why the Bank should demand that she should. In the opinion of their Lordships the mortgage imposed no liability on Mrs. Zyngier in respect of the bills unless there was default both by the acceptor and the drawer. Consequently, Scholefield, upon paying as drawer the amount due upon the bill, had no right of contribution against Mrs. Zyngier.

Scholefield sought to argue in the alternative that section 72 of the Supreme Court Act, which their Lordships quoted earlier, gave it a right of recourse against the security held by the Bank. It is however clear from the wording of the section, and implicit in the proviso thereto, that it does not confer on a person claiming to be a surety, a right of subrogation exercisable against another who is under no equitable obligation to make contribution.

The conclusion reached by their Lordships calls for a critical examination of two Australian authorities cited in argument. In *D. & J. Fowler (Australia) Limited v. Bank of New South Wales* [1982] 2 NSWLR 879 the plaintiffs ("Fowlers") drew bills on Tramore Pty. Limited ("Tramore") which were accepted. The bills were negotiated to the bank, which paid the discounted value to Tramore. The bills were dishonoured by Tramore on presentation, and were paid

by Fowlers as drawers. The bank was in fact secured in respect of moneys owed to it by Tramore. First, it held two equitable charges executed by Tramore over its assets. Secondly, it held a joint and several guarantee by three of the officers of the company and their wives ("the individual defendants"). Thirdly, it held three separate mortgages over houses owned by the individual defendants. The guarantee and the memoranda of mortgage were expressed to secure "all moneys which the bank hereafter pays to Tramore by reason of the bank having discounted any bill of exchange at the request of Tramore". The assets charged by Tramore were sold, and there was no dispute that Fowlers were entitled to be subrogated to the rights of the Bank under the equitable mortgage executed by Tramore. However, Fowlers also claimed the right to be subrogated to the bank under the joint and several guarantee and the memoranda of mortgage given by the individual defendants. It was held that Fowlers were so entitled by virtue of section 8A of the Usury, Bills of Lading and Written Memoranda Act 1902, corresponding to section 72 of the Supreme Court Act. It is not apparent from the report whether relief was granted on the basis that Fowlers were entitled to contribution from the individual defendants or to a full indemnity, but on either basis their Lordships venture to think that the decision was not correct. Section 72 does not give a right of subrogation to a surety when no right to indemnity or contribution exists. The first question has to be, whether the latter right does exist. This depended in *Fowlers'* case upon the true construction of the terms of the guarantee and of the three memoranda of mortgage. The full terms of these documents are not before their Lordships, but on the information provided by the report their Lordships doubt whether on the true construction of the documents the individual defendants constituted themselves as co-sureties with Fowlers or indemnified Fowlers against their liability as drawers. The natural meaning of the documents was more probably that they were merely securing to the bank the due fulfilment under the bills of the obligations of the parties thereto, so that the liability of the individual defendants was secondary to that of Fowlers as drawers.

Their Lordships were also handed a transcript of the decisions at first instance and on appeal of the Supreme Court of Queensland in *Maxal Nominees Pty. Limited v. Dalgety Limited* decided by the Full Court on 10th October 1984. In that case Dalgety Limited was the drawer and indorser of bills accepted by Brisbane Cap Co. Pty. Limited ("Brisbane") and discounted by the Commercial Banking Company of Sydney Limited. The bills were dishonoured, and the bank called for payment from Dalgety as drawer and indorser. Maxal Nominees Pty. Limited ("Maxal") had

given a bill of mortgage to the bank and executed an instrument of guarantee in the bank's favour, in respect of the indebtness of Brisbane, including "moneys due owing or payable to the bank in respect of any bill of exchange". Maxal claimed to be entitled to the discharge of the bill of mortgage, no further sums being due to the bank from Brisbane. Dalgety however claimed to be entitled to contribution from Maxal on the ground that Maxal was a guarantor of Brisbane's liability as acceptor of the bills, and also to be subrogated to the rights of the bank under the bill of mortgage. Dalgety's claim was upheld on the basis that it was entitled to a contribution from Maxal of half the amount it had paid as drawer and indorser of the bills. In so deciding the Court expressed its full agreement with the decision in the *Fowler* case. The Court relied upon section 4 of the Queensland Mercantile Acts 1867 to 1896, which was in the same terms as section 8A of the New South Wales Statute mentioned above; and the Court rejected the argument that the liability of Maxal did not arise except on the default of Dalgety as drawer and indorser of the bills.

Their Lordships doubt the correctness of this decision for the same reasons as they have given for doubting the correctness of the decision in the *Fowler* case. The first question to be decided was whether on the true construction of the bill of mortgage and instrument of guarantee Maxal, in relation to bills of exchange, was engaging that the bank as holder of a bill would be duly paid by the parties liable on the bill, or whether Maxal thereby constituted itself a co-surety liable on an equal footing with the drawer and indorser if the bill should be dishonoured. Their Lordships would expect the former to have been the true construction of the relevant documents, so that on the *Craythorne* principle Maxal was not liable to contribute.

Their Lordships respectfully agree with the conclusion reached by the Supreme Court of Victoria. They agree with the approach of the Honourable Mr. Justice Fullagar in the two passages which their Lordships have quoted from his judgment. Their Lordships will accordingly humbly advise Her Majesty that the appeal should be dismissed. The appellant will pay the costs of both respondents.