WHEN A FULL AND FINAL SETTLEMENT MIGHT NOT BE AS FULL AND FINAL AS INTENDED

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The High Court's recent Judgment in *Lavin v Toppi* contains useful reminders and guidance on the liability of co-sureties. Litigation & Insolvency Associate, Adam Khan, looks at the broader implications of the case.

THE FACTS

Mrs Lavin and Ms Toppi guaranteed a loan advanced by a bank to a company. Mrs Lavin and Ms Toppi were directors of the company. After the company went into receivership, the bank sued the guarantors. Mrs Lavin sought a declaration from the Court that the guarantee was unenforceable, but then settled the matter by payment of $1.35M. The settlement deed contained a covenant by the bank not to sue Mrs Lavin for the balance of the guaranteed debt.

Ms Toppi then sold her home and the proceeds of sale were used to pay the balance of the guaranteed debt to the bank, which was about $2.9M. The bank then discharged the guarantors from their obligations under the guarantee.

THE PROCEEDINGS

Ms Toppi successfully brought proceedings to recover a contribution from Mrs Lavin for the difference between the respective amounts paid by Mrs Lavin and Ms Toppi in discharging the guarantee. That decision was upheld on appeal. Mrs Lavin appealed to the High Court.

THE APPEAL TO THE HIGH COURT

On appeal, Mrs Lavin argued:

- her liability was different to Ms Toppi's because Ms Toppi's liability was enforceable by the bank whereas, because of the covenant not to sue, Mrs Lavin's was not;
- Ms Toppi had not benefited from Mrs Lavin's discharge and that was fatal since the purpose of contribution is to prevent the unjust enrichment by one co-surety at the expense of another; and
- at the time when Ms Toppi sought a contribution, there was no coordinate liability because Mrs Lavin could no longer be sued by the bank.

THE DECISION

The High Court dismissed the appeal and each of Mrs Lavin's arguments.

The following principles emerge from the Judgment:

- The rationale of the right to contribution is one of natural justice that ensures that persons who are under coordinate liabilities must share the burden pro rata.

- Once the company had defaulted on repayment (or once the bank had made a demand), the guarantors had a common obligation to pay the whole guaranteed debt. A covenant not to sue does not operate as a discharge of the guaranteed liability.

- The covenant not to sue meant the liability of Mrs Lavin was not enforceable by legal proceedings, but it was enforceable by other means such as reliance on rights of recoupment under other securities (if any) between the bank and Mrs Lavin.

- Without a right of contribution, the co-surety who pays less than his or her fair share in discharging the shared liability is unjustly enriched.

- On equitable grounds, the Court will step in to correct an imbalance if the creditor, who can demand payment from all guarantors, fixes one party with liability for all of the debt.

WIDER RELEVANCE AND IMPLICATIONS

There are a number of points to take from this decision:

- Co-guarantors should be wary before entering agreements with creditors unless the position with respect to the liability of other guarantors is fully understood.

- If a full and final agreement between a co-guarantor and a creditor contains, or is properly understood to be, a covenant not to sue, then it is unlikely to affect the co-guarantor's liability to other guarantors.

- A co-liability to a creditor is not discharged until it is fully paid or the creditor provides a full discharge and release.

- Creditors should be wary of the effect of entering an agreement with a single co-guarantor and providing full discharges for part payment of a debt when all that is really intended is a covenant not to sue.

It is advisable, prior to entering into an agreement with respect to a shared liability, that legal advice is sought and taken on the possible implications of the agreement.

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