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THE LAW OF SUBROGATION

Submitted in candidacy for the degree of Doctor of Philosophy

17th February 2000

Daniel Donnelly

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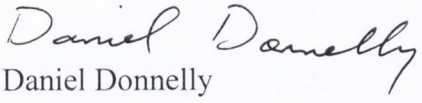

Daniel Donnelly

THE LAW OF SUBROGATION

SUMMARY

This thesis attempts a thorough review of the law of subrogation as applied in Ireland and England, with reference to the law of other common law jurisdictions and to the views of certain civil law writers. It first introduces the topic and then considers the juridical basis of subrogation. It also attempts to sketch the historical origins and derivation of the modern law of subrogation. Subrogation is generally divided into two categories by civilian and American writers, namely legal subrogation and contractual subrogation. Irish and English courts have not always been careful to make it clear which category they were applying. This has led to considerable confusion and controversy as to the relevance of intention to subrogation. Some authors have laid down the broad proposition that subrogation is a remedy to reverse unjust enrichment and nothing more. This thesis disputes the universal application of the "restitutionary hypothesis."

Part One of the thesis consists of three chapters. Chapter one of the thesis broaches the debate over the proper role of intention in subrogation. It then considers the restitutionary hypothesis, and suggests a number of shortcomings. It then considers the connected issue of whether subrogation is better considered as a right or a remedy. Chapters two and three consider such general propositions as can be made about subrogation. Chapter two considers requirements for the availability of subrogation, including the relevance of tracing. Chapter three considers restrictions and limitations on the availability of subrogation, and on the type of rights which can be exercised through subrogation in different contexts. Even within these two general chapters, it is necessary to distinguish between the diffferent contexts in which subrogation takes place on a number of occasions, because few rules can be stated which apply without qualification to all types of subrogation.

Part two of the thesis moves to somewhat more specific issues. It attempts to consider the broad categories of persons who may be entitled to subrogation, and the factors which so entitle them. The relevance of intention arises again here. The chapters in this part consider the general cases of the payer of another's debt and of the person who lends money to another for the purpose of discharging a debt.

Part three of the thesis is the most specific, and considers the application of subrogation in the most important contexts where it is applied, in so far as this treatment has not appeared in the first, general part. The topics covered are the subrogation of sureties and co-debtors, of vendors of incumbered estates, of assignors of leasehold interests, of insurers, of part owners of property. Finally, there is a chapter on marshalling of securities.

The conclusion of the thesis is that it is not possible or desirable to construct a single theory of subrogation, and that the theories which have been attempted are flawed. Subrogation developed as a

number of distinct legal institutions in different contexts, and still bears signs of these diverse origins. A great many instances in which subrogation occurs can be classified as "intention based." However, it is accepted that unjust enrichment has a role in some cases, in particular those where a tracing exercise is necessary as a prerequisite to subrogation.

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PART I

GENERAL PART

CHAPTER 1

DEFINITION, DERIVATION AND FUNCTION OF SUBROGATION

1.1 Subrogation introduced

Subrogation is a synonym for substitution. In a legal context, it is used as a metaphor to describe a transfer of rights from one party to another, though it literally means that one party is transferred to the position of another.[1] One well-known definition of subrogation is:

> "a transfer of rights from one person to another, without assignment or assent of the person from whom the rights are transferred and which takes place by operation of law."[2]

Although not contained in that definition, it is felt that it is central to a definition of subrogation properly called that the transfer of rights occurs as a consequence of a payment by the party who acquires the rights.[3] A number of points distinguish it from an assignment of a right of action. Chief among these is the fact that subrogation can take place by operation of law, without any act on the part of the creditor whose rights are transferred.[4] Indeed, it has been said that the creditor's consent is immaterial, at least in some circumstances.[5]

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[1] *Cf.* S.F. Dixon, *Substituted Liabilities, A Treatise on the Law of Subrogation* (1862), 7: "Subrogation is the substitution of another person in the place of a creditor, to whose rights he succeeds in relation to the debt" (paraphrased in *Johnson* v. *Barrett*, 117 Ind. 551; 19 N.E. 199 (1889); *Wilson* v. *Todd*, 217 Ind. 183, 187; 26 N.E. 2d 1003, 1005; 129 A.L.R. 192 (1940)).

[2] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 104 *per* Lord Diplock. This statement suggests that subrogation takes place irrespective of the attitude of the creditor. It should be noted that subrogation may take place through the assent of the debtor, *e.g.*, where a borrower re-finances a loan, and subrogates the lender to the position of a prior creditor. Furthermore, subrogation can take place with the assent of the creditor. Lord Diplock's statement does not envisage subrogation as a result of contract, which in fact is commonplace.

[3] The definition of Pothier was as follows:

> "Subrogation is a legal fiction, by which the creditor is deemed to cede his rights, actions, mortgages and priorities to him from whom he receives what is owing to him."

(M. Pothier, *Coutumes des Duché, Baillige et Prévoté d'Orléans, et ressort d'iceux*, n° 66 (in M. Dupin (ed.), *Oeuvres de Pothier*, X (1827)).

[4] Dixon, *op. cit.*, 7, 175.

[5] Dixon, *loc. cit.*; J. Mestre, *La Subrogation Personnelle* (Paris, 1979), n°s 21, 30.

Although it is a useful metaphor, the figure of speech should not be allowed to supplant the legal concepts which it seeks to describe.[6] The doctrines now encapsulated by the word were recognised long before the word itself entered common English usage.[7] Before the word came to be used, judges often used the metaphor of one party stepping into the shoes or place of another.[8] The attractive simplicity of the metaphor may have distracted attention from the widely differing characteristics of subrogation in different contexts. The species comprised in the modern genus subrogation have evolved with little cross-pollination.

As will be demonstrated, subrogation in modern common law systems finds application in a number of different contexts. Although rules applied in one context sometimes find analogies in other areas, there is considerable difficulty in attempting a complete synthesis. The structure of this thesis reflects this fact. The first part deals with certain general considerations, and then attempts to formulate such propositions as can be stated to apply generally to subrogation. Where a proposition seems true of certain instances of subrogation, but not of others, some discussion is made of the scope of application of the proposition and of the possible reasons for the divergences in application. The second part of this thesis deals with the broad categories of persons who are entitled to subrogation. The third part deals with the more important specific contexts in which subrogation arises. Although bold attempts have been made by some to rationalise all the law relating to subrogation in systems based on the prevention or reversal of unjust enrichment,[9] the present writer feels that there is no simple key to explain the entire body of law. Despite these attempts to effect a coalescence, the historical experience has been that centrifugal forces have been stronger than centripetal ones.

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[6] As to the dangers of metaphors in this legal context, as in others, see Mitchell, "Subrogation, Unjust Enrichment and Remedial Flexibility," [1998] Rest. L. Rev. 144, 145, and note 11.

[7] See *post*.

[8] See, *e.g.*, *R.* v. *Bennett* (1810) Wightw. 1, 7 *per* Graham B. ("It is quite clear ... that this Court has been in the habit of placing persons, who pay the Crown's debt, in the situation of the Crown."); *Salkeld* v. *Abbott* (1832) Hayes 576, 582-3; *Hodgson* v. *Shaw* (1834) 3 Mylne & K. 183, 191, 194 *per* Lord Brougham L.C.; *Small* v. *Currie* (1854) 23 L.J. Ch. 746, 756 *per* Turner L.J. Section 5 of the Mercantile Law Amendment Act 1856 (19 & 20 Vict., c. 97) itself stated that a surety or co-debtor who pays the creditor "shall be entitled to stand in the place of the creditor." For other instances, see, *e.g.*, *Thurstan* v. *Nottingham Permanent Building Society* [1902] 1 Ch. 1, 11, 12 *per* Romer L.J.; *Pitt* v. *Pitt* (1823) Turn. & R. 180, 183 *per* Sir Thomas Plumer M.R.; *Lawrence* v. *Galsworthy* (1857) 3 Jur. (n.s.) 1049, 1050; *Outram* v. *Hyde* (1876) 24 W.R. 268 *per* Hall V.-C. Indeed, similar expressions are still in common usage. See, *e.g.*, *Educators Mutual Insurance Association* v. *Allied Property and Casualty Insurance Co.*, 890 P. 2d 1029, 1030 (Utah 1995): "Subrogation is an equitable doctrine that allows a person or entity which pays the loss or satisfies the claim of another under a legally cognizable obligation or interest to step into the shoes of the other person and assert that person's rights"; *Stafford Metal Works, Inc.* v. *Cook Paint and Varnish Co.*, 418 F. Supp. 56, 58 (N.D. Tex. 1976); *Board of Education of Jordan School District* v. *Hales*, 566 P. 2d 1246, 1247 (Utah 1977); *Allstate Insurance Co.* v. *Ivie*, 606 P. 2d 1197, 1202 (Utah 1980); *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.* [1984] B.C.L.C. 1, 27, 40 *per* Oliver L.J.; *Derek Randall Enterprises Ltd. (in liq.)* v. *Randall* [1991] B.C.L.C. 379, 386 *per* Dillon L.J.

[9] C. Mitchell, *The Law of Subrogation* (1994); "Subrogation, Unjust Enrichment and Remedial Flexibility," [1998] Rest. L. Rev. 144, 144-5; P. Birks, *An Introduction to the Law of Restitution* (1985; rev. ed. 1989), 93-98, 372-5.

1.2 Persons entitled to Subrogation briefly stated

The persons who may avail of subrogation may be crudely categorised as (a) debtors or persons under an obligation who pay off a debt the ultimate burden of which should fall on another party; (b) creditors who pay off another creditor of a common debtor, or who lend funds to the debtor who pays off the other creditor and (c) persons with an interest in land who pay off an incumbrance thereon. In America, it has been repeatedly stated that the category of cases in which subrogation arises is "broad enough to include every instance in which one party pays a debt for which another is primarily answerable, and which, in equity and good conscience, should have been discharged by the latter."[10] The rhetoric of American cases is to the effect that subrogation has become applicable as a broad doctrine in such cases, and is not limited to traditional categories of cases of insurers, sureties and lenders.[11]

1.3 Juridical Basis of Subrogation

There are different theories as to the legal basis for subrogation in different contexts. In the United States and civil law jurisdictions, subrogation is usually classified as either legal or conventional.[12] The first category contains instances where the substitution takes place by operation of law, independent of expressions of intent of the parties. The second category consists of cases where the payer has agreed or is deemed to have agreed with either debtor or creditor that he should be substituted to the rights of the creditor.[13] Irish and English case law has not always distinguished these two categories with due care, though it is felt that each exists in the Irish and English legal systems. A recent prominent work on the law of subrogation deals almost exclusively with legal subrogation, and treats contractual subrogation in a

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[10] H.N. Sheldon, *The Law of Subrogation* (2nd ed., 1893), § 1, paraphrased in *In re Flick,* 75 B.R. 204, 206 (Bkrtcy. S.D. Cal. 1987) and *Matter of DiSanto and Moore Associates, Inc.*, 41 B.R. 935, 938 (N.D. Cal. 1984).

[11] G.E. Harris, *A Treatise on the Law of Subrogation* (1889), iii. See also *Bater* v. *Cleaver*, 114 N.J.L. 346, 353; 176 A. 889 (E. & A. 1935): "Subrogation has become more general in its application, the principle being modified to meet the circumstances of the individual case"; *Ambassador Insurance Co.* v. *Montes*, 76 N.J. 477, 485; 388 A. 2d 603 (1978); *Holloway* v. *State of New Jersey*, 593 A. 2d 716, 720 (N.J. 1991).

[12] Dixon, *op. cit.*, 7.

[13] See, *e.g.*, *McCollum* v. *Lark*, 187 Ga. 292; 200 S.E. 276 (1938) (express agreement with debtor, to whom subrogated party advanced funds). In France, a linguistic distinction has been drawn which has been obscured in common law jurisdictions: where a creditor pays another, that other creditor is said to "subrogate" the payer to his former position. Where a lender pays a borrower who applies the funds to pay another creditor, the borrower is said to "subrogate" the lender: Pothier, *op. cit.*, n° 69: "Subrogation occurs in different ways: either by operation of law, or by virtue of a demand made of the creditor, or by virtue of agreement with the creditor, or by virtue of agreement with the debtor." Hence, it has been said that the subrogated party holds his rights "of" the debtor, rather than of the creditor (Dixon, *op. cit.*, 10, evidently influenced by Philippe de Renusson, *Traité de la Subrogation de ceux qui succèdent au lieu et place des créanciers* (2nd ed., J.A. Sérieux,1780)). This language may be apt enough to describe conventional subrogation, but in cases where subrogation occurs by operation of law, it seems less useful.

rather off-handed manner.[14] However, Lord Hoffmann for one has recently acknowledged that subrogation encompasses (at least) two legal institutions: "The fact that contractual subrogation and subrogation to prevent unjust enrichment both involve transfers of rights or something resembling transfers of rights should not be allowed to obscure the fact that one is dealing with radically different institutions."[15] While subrogation in the context of insurance was not a pure creature of contract,[16] it nonetheless existed in order to give effect to the intention of the parties.

Legal subrogation has often been described as a creature of natural justice. In *Gadsden* v. *Brown*,[17] Johnson C. described it as a doctrine of "pure unmixed equity, having its foundation in the principles of natural justice."[18] In *In re 19th Ltd.*,[19] Lynch J. stated that "[t]he right of subrogation arises from equitable doctrines seeking to do justice between the parties." In the context of a surety, Barr J. said "this right is an equitable one and the granting of it is at the discretion of the court which will allow it only when satisfied that to do so is likely to achieve justice between the debtor and its guarantor."[20] It has been

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[14] C. Mitchell, *The Law of Subrogation* (1994).
[15] [1998] 1 All E.R. 737, 745.
[16] *Napier* v. *Hunter* [1993] A.C. 713. *Cf. Hobbs* v. *Marlowe* [1978] A.C. 16, 39 *per* Lord Diplock.
[17] Speers' Eq. 37 (S.C. 1843).
[18] Speers' Eq. 37, 41 (S.C. 1843), quoted in *Prairie State National Bank of Chicago* v. *United States*, 164 U.S. 227, 231 (1896) and *In re Alcon Demolition, Inc.*, 204 B.R. 440, 446 (Bkrtcy. D. N.J. 1997). In *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588, 598 (1837), Parker J. said "The doctrine of subrogation ... is the offspring of natural justice, and is not founded in contract." In *Bowen* v. *Hoskins*, 45 Miss. 183; 7 Am. Rep. 728, 729 (1871), Simrall J. stated that subrogation "does not arise out of contracts, but takes its root in the principles of natural justice." Subrogation has also been stated to be "founded on principles of equity and benevolence"(*Miller* v. *Holland*, 84 Va. 652, 659; 5 S.E. 701 (1888); *Beck* v. *Beiter*, 146 Pa. Super. 114; 22 A. 2d 90, 93 (1941)). In *Cheesebrough* v. *Millard*, 1 Johns. Ch. 409, 414 (N.Y. 1815), Kent C. said that "the rule of substitution rests on the basis of mere equity and benevolence." Similarly, *Cullum* v. *Emanuel*, 1 Ala. 23; 34 Am. Dec. 757, 761 (1840) and *Yonge* v. *Reynell* (1852) 9 Hare 809. See also Harris, *op. cit.*, iii: "Subrogation being a creature of equity, is administered upon principles of equity and benevolence, and only when the applicant has the equity to invoke the aid of the court, and not to the injury of innocent persons." In *Scott* v. *Dunn*, 1 Dev. & Bat. Eq. 425; 30 Am. Dec. 174, 176 (N.C. 1836), Gaston J. stated that subrogation was "founded on the plain obligations of humanity, which bind every one to furnish those aids to escape from loss which he can part with without injury to himself." In *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 140; 115 N.E. 465, 466 (1917), the court said that the doctrine of subrogation was "a device to promote justice." One may also note the opinion of Lord Kames (Henry Home, Lord Kames, *Principles of Equity* (1760), 1.1.1, at 11-12), in relation to the "connection" between creditor and surety (cautioner): "This connection which secures the creditor, makes benevolence his duty; so far at least as to aid the cautioner in claiming from the principal debtor what he the cautioner has advanced for him. The creditor has an intuitive perception that this is a moral duty; and every one has the same perception."
[19] [1989] I.L.R.M. 652, 655.
[20] *In re Chipboard Products Ltd. (in liquidation)*, unreported, 1984 No. 7316 P, judgment of Barr J., 20th October, 1994, at 11. It seems doubtful, though, whether a court really has a general discretion whether to "grant" subrogation. As to this, see *post*. Similarly, *Sullivan* v. *Naiman*, 32 A. 2d 589, 591 (N.J. 1943): "Subrogation is a device of equity, imported from the civil law, to serve the interests of essential justice between the parties." Also, *Leiter* v. *Carpenter*, 22 A. 2d 393 (Del. Ch. 1941); *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945).

described by American courts as being a doctrine "highly favoured in the law."[21] It has also been said that "[s]ubrogation is not a matter of strict right but is purely equitable in nature, dependent upon the facts and circumstances of each particular case."[22]

The earlier judicial statements which emphasised the role of natural justice seem gradually to have evolved into assertions that subrogation would be applied where reason and justice demanded it,[23] and that it took place in order to reverse or prevent an unjust enrichment. By way of contradistinction from contractual subrogation, Lord Hoffmann stated, "the term [subrogation] is also used to describe an equitable remedy to reverse or prevent unjust enrichment which is not based upon any agreement or common intention of the party enriched and the party deprived."[24] He emphasised that while mutual consent might be a necessary condition in cases of subrogation by intention, this was not so where it operated as a "restitutionary remedy."[25]

The appropriate questions to be asked in considering whether or not it should be "granted" as a restitutionary remedy were: (i) whether the defendant would otherwise be enriched at the plaintiff's expense; (ii) whether such enrichment would be unjust, and (iii) whether there were nonetheless reasons of policy for denying the remedy.[26] In the same case, Lord Steyn stated that "the place of subrogation on the map of obligations is by and large within the now sizeable corner marked out for restitution."[27]

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[21] *Schmid* v. *First Camden National Bank*, 130 N.J. Eq. 254, 266; 22 A. 2d 246 (Ch. 1941); *Standard Accident Insurance Company* v. *Pellecchia*, 15 N.J. 162, 171; 104 A. 2d 288 (1954); *Holloway* v. *State of New Jersey*, 593 A. 2d 716, 719 (N.J. 1991).

[22] *In re Co-Build Companies, Inc.*, 21 B.R. 635, 636 (Bkrtcy. E.D. Pa. 1982); *In re Bugos*, 760 F. 2d 731; 86 A.L.R. Fed. 877, 882 (C.A. 7th Ill., 1984). Similarly, *Philbrick* v. *Shaw*, 61 N.H. 356, 357 (1881); *Mitchell* v. *Smith's Estate*, 4 A. 2d 355, 358 (N.H. 1939).

[23] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 112 *per* Lord Salmon.

[24] *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744-5 *per* Lord Hoffmann.

[25] [1998] 1 All E.R. 737, 745. He also approved a statement of Millett L.J., in *Boscawen* v. *Bajwa* [1996] 1 W.L.R. 328, 335, who stated that subrogation is available "in a wide variety of different factual situations in which it is required in order to reverse the defendant's unjust enrichment." See also, *e.g.*, *Freeburg* v. *Farmers' Exchange Bankers* (1922) 63 D.L.R. 142, 144 *per* Turgeon J.A., affirming (1921) 61 D.L.R. 79 ("One of its objects is to prevent one person from benefiting without cost to himself by the act of another done under compulsion on his behalf and to his advantage and to that other person's loss or expense"); *In re T.H. Knitwear (Wholesale) Ltd.* [1988] 1 Ch. 275, 283 *per* Slade L.J.; *In re Alcon Demolition, Inc.*, 204 B.R. 440, 446 (Bkrtcy. D. N.J. 1997) (*per* Winfield J.: "The equitable effect of subrogation is to ensure that the subrogee, who had no choice but to perform his duties, will be compensated through exercise of the subrogor's rights. To allow the subrogor to keep his rights would result in unjust enrichment"); *Leiter* v. *Carpenter*, 22 A. 2d 393, 396 (Del. Ch. 1941); *Camden Trust Co.* v. *Cramer*, 136 N.J. Eq. 261; 40 A. 2d 601 (E. & A. 1945); *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945): "The remedy is based on the theory that somewhat the same equity operates which seeks to prevent the unjust enrichment of one person at the expense of another by permitting actions for reimbursement, contribution and exoneration, and in appropriate cases creates a relation somewhat analogous to a constructive trust."

[26] *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 747.

[27] *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 741-2, referring to Lord Goff of Chieveley and G. Jones, *The Law of Restitution* (4th ed., 1993), 526, 531, P. Birks, *An*

The analysis of Mitchell[28] is predicated very largely upon the ground that subrogation operates to prevent or reverse an unjust enrichment. Although Mitchell treats contractual subrogation rather briefly,[29] he regards subrogation generally as a restitutionary remedy: "the cases in which subrogation has been awarded to date can all be explained in restitutionary terms, and the award of subrogation in the future should be guided by reference to the principle of unjust enrichment."[30] The present thesis disagrees with the first of these propositions, and is sceptical as to the latter.[31] It is felt that there are difficulties in characterising many of the more common instances of subrogation as designed to reverse or prevent unjust enrichment. The necessary elements of the restitutionary analysis, and particularly that of Mitchell, will be set out before a discussion of some of the shortcomings of this approach.

First, in order to justify restitution, it must be shown that the enrichment at the expense of the claimant was *unjust*. It is now usual to identify a list of factors which may be said to be unjust in a sense sufficient to justify restitution. These include mistake, undue influence, compulsion, duress, incapacity and, arguably, necessity. Mitchell attempts to identify unjust factors which have justified subrogation in most of the better-known instances where it has been applied in English and Commonwealth case law. In the case of insurers and sureties, he identifies the relevant factor as being legal compulsion.[32]

The second element which must be established in order to justify a restitutionary remedy is that there was an enrichment of the defendant or another party at the expense of the claimant. In the case of sureties, co-debtors, or interveners whose payments effectively discharge the debt owed by a principal debtor, co-debtor, or other primarily liable party to the creditor, that party clearly receives a benefit in the form of relief from his obligation to the creditor. This benefit can be said to be an enrichment which the principal or primarily liable party receives at the expense of the payer. Mitchell asserts that in the case of insurers, if the insurer is not subrogated to the rights of the insured, then there will be an unjust enrichment at its expense. The identity of the party enriched may be either the third party liable, or the insured, depending on later events. If the insured does not pursue the third party, who goes free, then the

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Introduction to the Law of Restitution (1985), 93 *et seq.*, A. Burrows, *The Law of Restitution* (1993), 92 and C. Mitchell, *The Law of Subrogation* (1994), 4.

[28] C. Mitchell, *The Law of Subrogation* (1994).

[29] *Op. cit.*, chapter 13.

[30] *Op. cit.*, 4.

[31] *Cf.* Quinn, "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1362-3, referring to C. Mitchell, *The Law of Subrogation* (1994):

> "If Mitchell's thesis is trivial, it is because many cases, commentaries, and legal encyclopedias have repeated a version of his central thesis over and over again, virtually *ad nauseam*. Subrogation, it is said, and said, and said again, exists precisely to avoid unjust enrichment. If the thesis is uselessly obscure, that is because it fails to elucidate meaningfully the real relationship between subrogation and restitution."

third party has been enriched.[33] If the insured does pursue the third party, and effects a double recovery, then the insured has been unjustly enriched.[34]

The third question is that of policy. With a few exceptions,[35] this has not generally been an issue in cases of subrogation.

It is necessary here to state the intricacies of Mitchell's theory with some precision. He divides legal subrogation (*i.e.*, subrogation by operation of law) into two categories. The first is simple subrogation, which occurs where a payer is substituted to the position of a "right-holder" in order to enforce rights of the latter which subsist against a third party notwithstanding the payment made by the payer.[36] The pre-eminent example of this category is the subrogation of insurers. The other category is reviving subrogation. This applies in cases where the payment of a debt, either directly by the payer, or through the debtor, by means of a loan to him, *does* have the effect of discharging the liability of the debtor to the third party. In such a case, under certain circumstances, the rights of the third party against the debtor are said to be "revived" for the benefit of the payer or lender.[37]

In order to categorise instances of subrogation under this theory it is necessary to determine when the payer's payment has the effect of discharging the indebtedness or liability of the debtor to creditor (or "right-holder"). It seems to have been invariably accepted that a payment by an insurer does not have the effect of discharging the liability of a third party to the insured where the third party is legally responsible for the insured loss. In such cases, it is normally accepted that is proper to allow the insurer to shift the burden of the loss onto the third party. The matter is discussed in greater detail at a later point.[38] Similarly, payment by the drawer or indorser of a bill of exchange other than one accepted for the accommodation of the drawer does not have the effect of discharging the liability of the acceptor.[39]

By contrast with the above cases, a payment by a surety or co-debtor will be regarded as discharging the debt of the principal debtor or co-debtor. Since, *ex hypothesi*, the creditor is content to

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[32] *Op. cit.*, chapters 5 and 6.
[33] *Op. cit.*, 10. He notes that, although the insured's rights subsist in principle, in practice, the third party will escape from liability. This seems to be an admission that his scheme is not entirely rigorous.
[34] *Op. cit.*, 9.
[35] *Cf. Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, and section 3.5, *post*.
[36] *Op. cit.*, 5-6, 9-10.
[37] *Op. cit.*, 6-7, 10-11.
[38] Section 2.3, *post*.
[39] *Op. cit.*, 86-96.

accept payment from one whose undertaking to pay the debt he has accepted, there is no doubt as to this.[40] Opinion is divided as to whether a part payment operates as a part discharge.[41]

Since the payment discharges the liability of the principal or co-debtor to the creditor, the latter ceases to be in a position to claim from the principal or co-debtor. Therefore, it would appear that he can have no rights to transfer to the payer. It may be noted that the effect of the discharge of the debt is to confer on the payer a right to reimbursement from the principal debtor, or contribution from the co-debtor. This right is a personal claim, and exists independently of subrogation. Modern common law jurisdictions regard the surety as substituted by operation of law to the creditor's rights upon payment to the creditor. There is some difference of opinion as to whether the surety requires an actual assignment of securities in order to enforce them against the principal and subsequent incumbrancers. This topic is considered later.[42] The significance of the right of subrogation is that the surety or co-debtor is entitled to succeed to securities or proprietary rights which the creditor enjoyed against the principal or other co-debtor. Because there is a discharge of the debt and yet the surety is held entitled to enforce the creditor's rights against the principal, Mitchell refers to this type of subrogation as "reviving subrogation," the creditor's rights being revived, in a sense.[43]

As regards Mitchell's analysis of unjust factors, given that an insurer or surety enters into his engagement of his own free will, it seems to be a strained interpretation to say that he pays under legal compulsion.[44] It is more realistic to say that he pays upon the expectation that he will thereafter be permitted to reimburse himself from a third party or the principal debtor. This expectation may be characterised either as a contractual term or as a consequence which follows from his status as insurer or surety unless renounced expressly or by implication.[45] There are, however, other instances where a payer is held entitled to indemnification or subrogation, and yet there can be no contractual nexus between him and the party held liable to him.[46]

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[40] See section 2.3, *post.*

[41] Against discharge *pro tanto*: *In re An Arranging Debtor, No. A. 1076* [1971] N.I. 96, 106. In favour: Mitchell, *op. cit.*, 55 note 20, citing *Davies* v. *Humphreys* (1840) 6 M. & W. 153, 167 *per* Parke B.

[42] Sections 3.9 and 7.8.

[43] *Op. cit.*, 6-7, 10-11.

[44] *Cf.* Birks, *op. cit.*, 186, observing that if the creditor enforces payment from the surety, "the substance of the matter" was that the surety had paid the principal debtor's debt rather than his own: "Hence the guarantor is given a restitutionary claim against the principal debtor, to which the latter cannot object that the pressure applied to the guarantor was lawful and necessarily exempt from restitution."

[45] In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 747, Lord Hoffmann regarded some cases of subrogation as arising by virtue of contract. It should be noted that the surety's right of subrogation had a statutory basis under the Mercantile Law Amendment Act 1856, section 5, prior to the repeal of that Act in Ireland. It is still in force in England and Northern Ireland. If the surety or co-debtor's right of subrogation derives from statute (as well as from equity), it is hard to see how it can be regarded as a "remedy" to prevent unjust enrichment, and yet this appears to be Mitchell's view.

[46] See, *e.g.*, chapter 9.

As regards the question of an enrichment, Mitchell argues, as has been seen, that, if subrogation of an insurer does not take place, the third party who was liable for the loss will be enriched by evading liability for a wrong. Mitchell takes the view that in the circumstances under consideration, the wrongdoer is enriched at the expense of the insurer. However, the causal link between the insurer and the wrongdoer is a weak one. There are two separate incidents: the doing of the wrong and the payment by the insurer. While there may be sound policy reasons (in many cases) for placing the burden of the loss on the party which caused it, it is felt that it is strained to argue that the wrongdoer would otherwise be unjustly enriched at the insurer's expense. Even in the second case, the effect of holding the insurer to have been subrogated would not be to reverse an unjust enrichment, which is usually described as the purpose of restitution.[47] Rather, it would be to *prevent* an unjust enrichment.[48]

On a restitutionary analysis, the amount which the claimant of a restitutionary remedy is entitled to recover is measured by the enrichment received or retained by another party. Where an insurer or surety is held to have been subrogated, he is almost always allowed to recover from the debtor the amount which he paid to the creditor, with any costs which he had to pay to the creditor, and possibly his own costs, if he reasonably incurred them in defending his own interest.[49] The debtor can hardly be said to have been enriched by the amount of either sets of these costs. There is another fundamental rule, namely that the payer may recover by subrogation *no more* than he paid to the creditor, with the stated provision for costs.[50] Thus, if the payer settles the creditor's claim for less than the full amount, he cannot recover the full amount of the claim from the debtor. Yet, the enrichment of the debtor is equal to the full value of the claim, unless the debtor himself could have negotiated an identical settlement. It therefore appears that, at least in cases of insurers and sureties, the amount which the payer may recover is not measured by the debtor's enrichment.

It is generally denied that there is any potential overlap between liability in contract and in restitution.[51] Those who regard subrogation as a restitutionary remedy therefore deny any entitlement to

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[47] *Cf.* Birks, *op. cit.*, 17 ("Restitution and unjust enrichment identify exactly the same area of law. The one term simply quadrates with the other"), 58. However, he also acknowledges (at 25) that unjust enrichment can be prevented by anticipation. The persistence of property rights where property passes through the hands of other persons is one such example. As nothing is restored, there is no "restitution."

[48] A. Burrows, *The Law of Restitution* (1993), 81 and 92. Mitchell acknowledges this at 10, but concludes that "it may at least be said that the remedy's proper place is alongside the law of restitution, if not squarely within it." This seems to be another admission that his scheme is not rigorously precise. Note also *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744-5 *per* Lord Hoffmann, and Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 225 note 12. See also note 33, *ante*

[49] See sections 7.2.a and 7.2.b.

[50] Section 3.6.

[51] Birks, *op. cit.*, 44-7.

indemnification or subrogation if the payer has other recourse against the primarily liable party.[52] If, however, a payer's right to subrogation is held to derive from his intention, then the co-existence of an express contractual right of recourse need not be inconsistent with a right to indemnification or subrogation. The issue has arisen from time to time in cases where a surety had an express right to indemnification.[53] It seems that the more recent cases, at least in Ireland, recognise the potential overlap of the two rights, and therefore lend some support to the view that the surety's recourse is not normally based on unjust enrichment.[54]

In an admittedly exceptional case, subrogation of a payer is permitted only with leave of the court. This is the case where one pays the wages of the crew of a ship. In order to obtain the priority of the lien which they enjoy for their wages, he must apply to court prior to payment for leave to make the payment, and an order subrogating him to the crew's lien.[55] While the case is peculiar to itself, it seems hard to explain subrogation by judicial sanction as designed to prevent an unjust enrichment.[56]

Another peculiar case of subrogation is that where the creditor of a trustee is subrogated to the trustee's right of indemnity from the trust funds.[57] This seems to owe little to other forms of subrogation,

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[52] Goff and Jones, *op. cit.*, 48-53; O'Dell, [1993] Rest. L. Rev. § 161 (on *Highland Finance Ireland Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1992] 1 I.R. 472, later affirmed [1998] 2 I.R. 180). In *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.* [1984] B.C.L.C. 27, 36, reversing [1984] B.C.L.C. 1, affirmed on other grounds [1984] B.C.L.C. 259, Oliver L.J. said that, aside from insurance cases, he was "far from convinced, all other considerations apart, that the equitable principle [of subrogation] applies where the payer has already a full and independent right of recovery against the debtor."

[53] In *Toussaint* v. *Martinnant* (1787) 2 T.R. 100 and *Joyce* v. *Steele* (1827) 1 Law Rec. (o.s.) 56, an express limited right to indemnification was held to exclude any broader right by operation of law (in the latter case, an underlessee had been evicted and sued the immediate lessee for damages; it was held that an express qualified covenant for quiet enjoyment by the immediate lessee ousted any independent right). In *Cooper* v. *Jenkins* (1863) 32 Beav. 337, a surety's right to subrogation under section 5 of the Mercantile Law Amendment Act 1856 (19 & 20 Vict., c. 97) was held to have been waived by the taking by the surety of security from the principal debtor.

[54] *In re Pring, A Bankrupt* (1947) 81 I.L.T.R. 116, 119 (*per* Dixon J.); *In re Chipboard Products Ltd. (in liquidation)*, unreported, 1984 No. 7316 P, judgment of Barr J., 20th October, 1994. In accord with this view are: *Gossin* v. *Brown*, 11 Pa. 527, 533 (1849) (*per* Bell J.: "In accepting additional means of safety, it is not to be supposed [the surety] intended to extinguish those he already possessed"), *Brandon* v. *Brandon* (1859) 3 De G. & J. 524, and *In re Eastern Marine, Inc.*, 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989).

[55] *The "Kammerhevie Rosenkrants"* (1822) 1 Hagg. Adm. 62; *The "John Fehrman"* (1852) 16 Jur. 1122; *The "Duna"* (1861) 6 Ir. Jur. (n.s.) 358; 1 Mar. L.C. 159; 5 L.T. 217; *The "Cornelia Henrietta"* (1866) L.R. 1 A. & E. 51; *The "Petone"* [1917] P. 198; *The "Leoborg" (No. 2)* [1964] 1 Lloyd's Rep. 380; *The "Berostar"* [1970] 2 Lloyd's Rep. 403; *The "Vasilia"* [1972] 1 Lloyd's Rep. 51; *The "Guiseppe di Vittorio" (No. 2)* [1998] 1 Lloyd's Rep. 661, 672.

[56] Mitchell, *op. cit.*, 148, identifies the unjust factor as failure of consideration, which does not seem at all apposite.

[57] See, *e.g.*, *In re Morris, deceased* (1889) 23 L.R. Ir. 333; *In re Hodges; Hodges* v. *Hodges* [1899] 1 I.R. 480; *Kirkwood* v. *Hamilton* (1902) 36 I.L.T.R. 155; *Moore* v. *McGlynn* [1904] 1 I.R. 334; *O'Neill* v. *McGrorty* [1915] 1 I.R. 1; *In re Geary; Sandford* v. *Geary* [1939] N.I. 152; *Octavo Investments Pty. Ltd.* v. *Knight* (1979) 144 C.L.R. 360. English authorities are cited by Mitchell, *op. cit.*, 156, note 32.

and may be no more than a form of equitable attachment of a right of indemnity.[58] Mitchell, however, classifies these cases as ones where there is a failure of the consideration for the payment or loan by the creditor. As the creditor deals with the trustee, and presumably has a valid contract with him, Mitchell's classification seems most peculiar, especially as he deals with this situation under the rubric of "invalid contract."[59]

Marshalling is a doctrine applied by the courts under which a prior creditor with surplus security on a number of assets of a debtor is prevented from frustrating the claim of a subsequent creditor of the same debtor with security over some but not all of the assets comprised in the prior creditor's security.[60] It is generally held, that if the prior creditor realises his claim out of that portion of the security over which the subsequent creditor has his security, thereby preventing the subsequent creditor from realising any value from that security, the subsequent creditor will, subject to certain limitations, be subrogated to the rights of the prior creditor as against the remainder of his security. In his brief treatment of marshalling, Mitchell describes it as a type of simple subrogation.[61] He seems to attempt to fit marshalling within his restitutionary framework, identifying the relevant unjust factor as being the failure of the consideration which the subsequent creditor received for his loan, namely the insufficiency of the security which he took. This seems an odd characterisation, however, as the subsequent creditor obtained precisely the security which he bargained for, and would normally be taken to have had notice of the prior security. It is perhaps arguable that the debtor would be unjustly enriched if the subsequent creditor were unable to ensure recovery of his loan by means of a security. Even if this were so, however, it really amounts to saying no more than that the subsequent creditor's security may not be sufficient: the subsequent creditor presumably retains his personal right of action against the debtor.[62]

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[58] In *In re Hodges; Hodges* v. *Hodges* [1899] 1 I.R. 480, 484, it was said to operate so as to avoid circuity of action. *Cf. Johnson* v. *Diamond* (1855) 11 Ex. 73, holding that a judgment creditor could not attach by way of garnishee proceedings the claim of the debtor to a contractual indemnity by the proposed garnishee, as the entitlement under the contract of indemnity was not a "debt" owing to the debtor (see also *Israelson* v. *Dawson (Port of Manchester Insurance Company Ltd., garnishees)* [1933] 1 K.B. 301). By contrast, receivers have been appointed by way of *equitable execution* over a debtor's claim for an indemnity from a third party; see, *e.g.*, *Bourne* v. *Colodense Ltd.* [1985] I.C.R. 291, 305 *per* Dillon L.J., although this result seems hard to reconcile with the often stated view that a receiver cannot be appointed over future debts. More recent case law seems to have eroded this rule: *Soinco S.A.C.I.* v. *Novokuznetsk Aluminium Plant* [1997] 3 All E.R. 523.

[59] Furthermore, he (correctly) describes these cases as ones of simple subrogation, by his terminology, because there has been no discharge of any previously existing debt, However, he states that these cases properly share a category with ones where money paid was used to discharge a pre-existing debt, which seems entirely self-contradictory: *op. cit.*, 154-6.

[60] See chapter 12.

[61] *Op. cit.*, 143.

[62] Assuming that he was under a personal liability: he might have succeeded to an estate burdened with charges.

As regards insurers, it is felt that there is more weight in the argument that the third party should not be allowed to escape liability for his wrongdoing.[63] This seems really to be an application of the theory that parties which are responsible for causing loss or damage should bear the economic burden of that loss or damage.[64] As regards sureties, it has long been accepted that, as they enter into their obligation in an accessory character, for the accommodation of the principal debtor, natural justice and ethics require that they should, in so far as possible, be exonerated by the principal, who is normally the party who receives consideration from the transaction.[65] If the surety can be said to pay under legal compulsion, it is a compulsion to which he agreed to submit himself. Therefore, his rights of indemnification and subrogation are perhaps best understood as expressions of policy, with an underlying moral justification, that, in so far as possible, one should not be damnified for lending one's credit on behalf of another. An economic justification is that securing indemnification, subordinated only to the creditor's right to be paid in full, encourages the granting of guarantees, and facilitates an expansion of secured credit, thereby providing a stimulus to economic activity.[66]

In some cases, subrogation can be combined with tracing in order to enable a claimant to enforce rights against the recipient of his money similar or identical to those formerly held by a creditor who had

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[63] See, *e.g.*, *Stafford Metal Works, Inc.* v. *Cook Paint and Varnish Co.*, 418 F. Supp. 56, 58 (N.D. Tex. 1976), giving three reasons for the subrogation of insurers: "(1) that the person who in good faith pays the debt or obligation of another has equitably purchased (quasi-contractually), or is at least entitled to, the obligation owed by the debtor or tortfeasor; (2) that the wrongdoer (tortfeasor) is not entitled to a windfall release from his obligation simply because the injured party had the foresight to obtain insurance; and (3) that public policy is served by allowing insurers to recover and thus reduce insurance rates generally."

[64] See S.R. Derham, *Subrogation in Insurance Law* (1985), 156-8. Derham identifies this theory as deriving from the "free market" principle - that the costs of accidents should be placed on those who can most cheaply avoid them. However, the former Soviet Union seems to have applied this theory with some determination (to the extent of banning liability insurance): Rudden, "Soviet Tort Law," (1967) 42 N.Y.U.L. Rev. 583, 625, note 173.

[65] *Cf.* Birks, *op. cit.*, 186: "A loose way of saying why this happens is that in giving the creditor two claims the law may allow him to get substantially the wrong man." One may compare the view of J. Story, *Commentaries on Equity Jurisprudence* (13th ed., M. M. Bigelow, 1886), § 499, comparing the surety's right to contribution to the doctrine of marshalling: "a creditor shall not, by his own election of the fund out of which he will receive payment, prejudice the rights which other persons are entitled to; but they shall either be substituted to his rights, or they may compel him to seek satisfaction out of the fund to which they cannot resort." In *Goree* v. *Marsh* (1690) 2 Freem. 113, the court indicated that, if a creditor had claims on two funds, but another a claim on one alone, the former "ought not to be chancellor, so as to be under his power whether the debts should be paid or not, so long as he is not at any prejudice, but must have a satisfaction."

[66] The moral and economic impulses can, arguably, clash, however. One example might be the widespread practice of limiting the surety's rights in standard forms of guarantee. Under the Roman Republic, some forms of suretyship became obsolete because of legislation which increased the protection given to sureties who undertook their liability in those forms. As a response, creditors resorted to other forms which did not receive that protection. Once again, Justinian legislated to protect the surety (Novel 4, chapter 1), and it was not long before other ways were found to circumvent most of his legislation. See, *e.g.*, Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), 121 (speaking of the earlier legislation): "This development provides a good example of how well-intentioned legislation, designed to achieve a better result for the debtor, can in the end defeat that very purpose."

been paid off with the use of that money.[67] In this situation, subrogation is more amenable to an unjust enrichment analysis, although arguably it could be regarded as the enforcement of a proprietary right to the substitute of the original property of the claimant.[68]

Birks has expressed the view that subrogation is merely an unnecessary metaphor to describe an action for the recovery of the amount of value traceable from the plaintiff into the discharge of the defendant's obligations.[69] The only purpose of the metaphor in his view was to measure the amount of the enrichment which "survived" in a recipient's hands (through the discharge of his obligations). Further, even if one persisted in using the word "subrogation," subrogation to a proprietary or secured right should be allowed only if the payer could establish that he had a "proprietary base" in the money or property which came to the hands of the debtor and was used to discharge a debt.[70] This part of Birks' theory is discussed in a later section. However, Birks acknowledges a competing, "intention-based" theory which holds that a payer who pays off a secured creditor or lends money to a debtor for that purpose, is presumed to have intended to obtain the benefit of the creditor's security for himself.[71]

The relevance of intention to certain instances of subrogation is a troublesome question. Both intention or presumed intention and unjust enrichment have been advanced as the reason for subrogation in certain cases of payments of another's debt, or loans for the purpose of such a payment. A considerable body of cases[72] explained the occurrence of subrogation in such circumstances as turning on the intention or presumed intention of the payer. However, Mitchell is profoundly hostile to these cases, stating that the presumption of intention is entirely misconceived, and is an erroneous extension of a similar presumption in favour of part-owners of property who paid an incumbrance on it.[73] The presumed intention analysis has also received a broadside from Lord Hoffmann, who has stated:

> "The fact that contractual subrogation and subrogation to prevent unjust enrichment both involve transfers of rights or something resembling transfers of rights should not be allowed to obscure the fact that one is dealing with radically different institutions. Unless this distinction is borne in mind, there is a danger that the contractual requirement of mutual consent will be imported into

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[67] *E.g.*, *Pittsburgh-Westmoreland Coal Company* v. *Kerr*, 220 N.Y. 137; 115 N.E. 465 (1917); *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769.
[68] See section 2.2, *post.*
[69] Birks, *op. cit.*, 93-98, 372-5.
[70] *Op. cit.*, 390. See on this latter point, *post.*
[71] *Loc. cit.*, referring to *Wylie* v. *Carlyon* [1922] 1 Ch. 51 and *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732, 745.
[72] See section 4.1, *post.*
[73] *Op. cit.*, 12-14. Mitchell's argument, as expressed in "The Law of Subrogation," [1992] L.M.C.L.Q. 483, was not accepted by the Court of Appeal of England and Wales in *Castle Phillips Finance* v. *Piddington* (1994) 70 P. & C.R. 592. For the case of part owners, see chapter 11.

the conditions for the grant of the restitutionary remedy or that the absence of such a requirement will be disguised by references to a presumed intention which is wholly fictitious."[74]

He regarded talk of presumed intentions as artificial. However, it is hard to judge the scope which he attributed to contractual or "real intention"- based subrogation. He refers to the subrogation of insurers as an example,[75] but does not seem to exclude other instances of subrogation from this category. One passage in his judgment creates difficulties. He refers to cases where the court repeated that if a payer or lender advanced money to pay an incumbrance, he was presumed to have intended to be subrogated to the incumbrancer's rights. These cases seem clearly to envisage a contractual basis for subrogation. However, Lord Hoffmann then seemed to attempt to rationalise them with an unjust enrichment hypothesis, stating that the intentions of the parties might be relevant in deciding whether or not an enrichment was unjust.[76] It is therefore hard to say whether Lord Hoffmann regarded cases of payments or loans by a third party to pay off an incumbrance as resting on contract or unjust enrichment, or sometimes on one and sometimes on the other. It is felt that the last possibility is perhaps the most accurate. Although Mitchell condemns the "presumed intention" analysis, he nonetheless recognises a role for intention, though he argues that the payer should bear the burden of proving that he intended to be subrogated or otherwise secured.[77] Wherever the burden of proof may lie, if intention is a determining factor, then subrogation in such a case seems far more likely to be a creature of contract than of unjust enrichment. The rationale for the presumed intention is that of self-interest: it was in the interest of the payer that his right to recover should obtain the highest priority available. As this is no more than a presumption, it may easily be rebutted, as by evidence that an unsecured loan was intended, or by the taking of another security.

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[74] [1998] 1 All E.R. 737, 745. In *In re T.H. Knitwear (Wholesale) Ltd.* [1987] 1 W.L.R. 371, Brown-Wilkinson V.-C. had stated (at 376) that subrogation was invariably based on the intention or presumed mutual intention of the creditor and payer. On appeal, the court accepted that this was too narrow a view, and that subrogation could occur where it was impossible to infer a mutual intention to that effect: [1988] 1 Ch. 275, 286 (*per* Slade L.J.). In the earlier case of *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 104, Lord Diplock had expressed himself cautiously, stating that some instances of subrogation appeared to "defeat classification except as an empirical remedy to prevent a particular kind of unjust enrichment." He also noted that the word "subrogation" "embrace[d] more than a single concept in English law." In *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, to which Lord Hoffmann referred as establishing that mutual or presumed intention on the part of the payer was not necessarily a prerequisite for subrogation, Millett L.J. nonetheless referred to the presumed intention of fiduciaries which had received the claimant's money and used it to pay off a debt: "As fiduciaries, they could not be heard to say that they had paid out their principal's money otherwise than for the benefit of their principal...their intention must be taken to have been to keep the .. charge alive for the benefit of [their principal]" (at 781). Granted that this passage specifically refers to the case of fiduciaries, nonetheless, the judge utilises an apparently conclusive presumption of the intention of the party which received the money, as against the initial payer.

[75] [1998] 1 All E.R. 737, 744-5.

[76] [1998] 1 All E.R. 737, 747.

[77] *Op. cit.*, 145-7.

1.4 The Function of Subrogation: An Instrument to apportion liability among several liable in respect of the same debt or loss

Many courts have placed an emphasis on the role of subrogation in transferring the burden of loss onto a person who is "primarily liable," or who, it is felt, should bear the loss rather than the payer.[78] This language is most apt in cases of insurers, sureties or co-debtors. In this context, in America, subrogation has been described as "a mode which equity adopts, to compel the ultimate discharge of a debt by him who in equity and good conscience ought to pay it, and to relieve him whom none but the creditor could ask to pay."[79] The principle has sometimes been stated in a more general way: "Subrogation rests on the equitable principle that one, other than a volunteer, who pays for the wrong of another should be permitted to look to the wrongdoer to the extent that he has paid a debt or demand which should have been paid by the wrongdoer."[80] Although this formulation excludes a volunteer from an entitlement to subrogation, it does not attempt a definition of a volunteer, and is therefore unsatisfactory. Further, the word "wrongdoer" is itself unsatisfactory, as it is not appropriate to describe a simple debtor as such.

These definitions do not appear properly to apply to situations where a person lends funds to a borrower, and is held to have been subrogated to the position of one who has been paid by way of those funds. Many of these cases seem to be best understood as cases of subrogation occurring because of the

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[78] See, *e.g.*, *Duncan, Fox & Co.* v. *North and South Wales Bank* (1880) 6 App. Cas. 1, 10 *per* Lord Selborne L.C.; *In re Downer Enterprises Ltd.* [1974] 1 W.L.R. 1460, 1468 *per* Pennycuick V.-C.: "this right of reimbursement, which carries with it the right of subrogation is not confined to the case of a guarantee, but applies in any case where there is a primary and secondary liability for the same debt." *Cf.* Alger, "The Doctrine of Subrogation Pro Tanto," (1962) 29 Ins. Counsel J. 426, 427 (in the context of suretyship): "Regardless of the area of law in which subrogation is applied, its roots are found in the moral precept that the ultimate loss should fall upon the party causing the loss ... The unjust enrichment is avoided and the loss is placed upon the shoulders of the person who should pay the loss by substituting the surety to the position of its obligee." See also Mestre, *op. cit.*, n° 18.

[79] H.N. Sheldon, *The Law of Subrogation* (2nd ed., 1893), § 11, paraphrasing a passage in the judgment of Strong J. in *McCormick's Administrator* v. *Irwin*, 35 Pa. 111, 117 (1860). Strong J.'s statement, or Sheldon's version of it, have been repeated on numerous occasions by American courts and writers: see, *e.g.*, G.E. Harris, *A Treatise on the Law of Subrogation* (1889), iii, § 1; *Catskill National Bank* v. *Dumary*, 206 N.Y. 550, 559; 100 N.E. 422 (1912); *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 144, 115 N.E. 465, 467 (1917); *Bater* v. *Cleaver*, 114 N.J.L. 346, 353; 176 A. 889 (E. & A. 1935); *Schmid* v. *First Camden National Bank*, 130 N.J. Eq. 254, 266; 22 A. 2d 246 (Ch. 1941); *Camden Trust Co.* v. *Cramer*, 136 N.J. Eq. 261; 40 A. 2d 601, 603 (E. & A. 1945); *Liberty Mutual Insurance Co.* v. *Borsari Tank Corporation*, 248 F. 2d 277, 289 (2nd Cir. 1957); *DeCespedes* v. *Prudence Mutual Casualty Co.*, 193 So. 2d 224 (Fla. 1966), affirmed 202 So. 2d 561 (1967); *Ambassador Insurance Co.* v. *Montes*, 76 N.J. 477, 485; 388 A. 2d 603 (1978); *Allstate Insurance Co.* v. *Ivie*, 606 P. 2d 1197, 1202 (Utah 1980); *Holloway* v. *State of New Jersey*, 593 A. 2d 716, 720 (N.J. 1991); *In re Valley Vue Joint Venture*, 123 B.R. 199, 208-9; 21 Bankr. Ct. Dec. 513; 13 U.C.C.R. Serv. 2d (Callaghan) 842 (Bkrtcy. E.D. Va. 1991); *Westchester Fire Insurance Co.* v. *Allstate Insurance Co.*, 236 Conn. 362; 672 A. 2d 939; [1997] Rest. L. Rev. § 264, note by Kull; *Wetzler* v. *Cantor*, 202 B.R. 573, 576-7 (D. Md. 1996); *Educators Mutual Insurance Association* v. *Allied Property and Casualty Insurance Co.*, 890 P. 2d 1029, 1030 (Utah 1995). Similarly, see *Stevens* v. *Goodenough*, 26 Vt. 676 (1854); *Lewis* v. *Palmer*, 28 N.Y. 271 (1863).

express or implied intention of the parties. Even in cases of sureties, co-debtors or insurers, where the above-quoted definitions seem most apt, they beg the question: who is the party on whom the ultimate loss should fall?

This question seldom raises difficulties in the context of insurance. It is generally held that, as between a contractually-bound insurer and a third party who is liable to the insured for a loss either under contract or in tort, the loss should fall on the latter. A recognised exception is where a contract between the insured and the third party provided that the third party should have the benefit of the insurance, and thus be exempt in the case of payment by the insurer.

Similarly, there is no controversy in stating that a surety is entitled to indemnification from the principal debtor. More difficult questions may arise where a number of persons are jointly or jointly and severally liable to the creditor. The proper incidence of liability *inter se* may be hard to establish.[81]

1.5 History and Development of Subrogation

At the present time, subrogation is applied in a number of different legal contexts. It is not possible to establish with certainty the derivation of the doctrine in English and Irish law. However, the theory set out here is to the effect that the modern doctrine of subrogation (in so far as such a thing may be said to exist) is a fusion of a number of different legal rules and practices which had been absorbed into English law from the civil law,[82] primarily through courts exercising equitable jurisdiction.

Civil law writers tend to point to two institutions of Roman law as the antecedents of the civil law of subrogation. These institutions remained distinct for a long time, probably until the sixteenth century. The first institution was the benefit of the ceding of actions, *i.e.*, the right enjoyed by certain categories of persons, principally sureties and co-debtors, to demand that the creditor assign (or cede) his action(s) against the principal debtor or the co-debtors to the payer, upon payment. The importance of this right was that in many instances, for technical reasons, sureties did not have direct rights of

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[80] *First National Bank of Columbia* v. *Hansen*, 84 Wis. 2d 422, 428; 267 N.W. 2d 367, 370 (1978).

[81] See *post*.

[82] One author proposed the origin as being Talmudic law: Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1339 note 10, on the basis that Talmudic law recognised the principle that a surety whose payment discharged the principal debtor was entitled thereupon to claim reimbursement from the principal debtor. Disclaiming any ethnic chauvinism, the present writer feels that he should point to the equally meritorious claim of early Irish law: see F. Kelly, *A Guide to Early Irish Law* (1988), 168 (indeed, if the surety was forced to pay, the principal would have to pay a penal sum to the surety); T. Hewitson, *Suretyship, Its Origin and History in Outline* (1927), 116.

indemnification against principal debtors,[83] or of contribution against co-sureties.[84] The continued existence of the creditor's rights notwithstanding the payment by the surety was explained by recourse to the fiction that the creditor had sold them to the surety.[85] It must be noted that the paying surety or debtor had to demand the assignment prior to or at the time of payment.[86] If it were requested after payment, the creditor's rights would often be regarded as having been discharged, and an assignment as being impossible.[87] If the assignment were requested prior to payment, but was only made thereafter, it would

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[83] A *fideiussor* could claim reimbursement from the principal debtor by action on the administration of affairs if he had paid without a request from the principal debtor, though not expressly against his will. By contrast, a *mandator* could only recover in such circumstances if he obtained a cession of the creditor's rights against the principal debtor. The reason for the distinction was apparently that the obligation of the *fideiussor* was secondary to that of the principal, which was extinguished by payment, even if the *fideiussor* had undertaken his liability without a request from the principal. A *mandator* had no recourse against the principal debtor unless the creditor ceded his actions to him. The reason for this was that the *mandator*'s obligation was distinct from that of the principal, and payment by the *mandator* would not release the principal from liability. Also, where one became a *mandator* without the assent of the principal debtor, one could not bring an action against him on the management of his affairs, as the *mandator* had technically managed *his own affairs*, rather than those of the principal: D. 17.1.28 (Ulpian); D. 5.3.31 pr. (Ulpian) ("a payment by anyone in his own name, not that of the debtor, does not free the debtor"); J. Voet, *Commentary on the Pandects* (translated by P. Gane, *sub tit.* "*The Selective Voet, being the Commentary on the Pandects*," VII, 1957), 3.5.13; 46.1.30. Thus, the only way in which the *mandator* could obtain relief in that case was by obtaining a cession of the creditor's action against the principal from the creditor: Voet, *op. cit.*, 46.1.30. See D. 46.1.13 (Julian). If one became *fideiussor* against the will of the principal, one could not have the action on mandate, or, it seemed, the action on the administration of affairs either. However, one could still claim a cession from the creditor of his rights against the principal: Voet, *loc. cit.*

[84] If a *mandator* wished to obtain contribution from his *co-mandatores*, he required a cession: D. 46.1.41.1 (Modestinus). The *fideiussor* would also require a cession if he wished to recover a contribution from his co-sureties, as he could have no action on mandate or the administration of affairs against them: D. 46.1.17 (Julian); D. 46.1.36 (Paul) (stating that by making over the actions against the co-sureties, the creditor is in effect selling them, rather than extinguishing them); C. 8.40 (41).11; Voet, *op. cit.*, 46.1.28: "one who pays the whole is understood to have managed not the affair of another but his own affair, and to have paid the whole, even as he owes the whole, not in order that he may release others, but that he may release himself." The *fideiussor* or *mandator* was entitled to the creditor's rights in respect of pledges or security given as well: D. 46.1.59 (Paul) (*cofideiussores*). In the eighteenth century, Kames still maintained that one surety had no right to contribution from his co-surety other than through the creditor's obligation to assign his securities to the paying surety: *op. cit.*, 13.

[85] D. 46.1.36 (Paul). *Cf.* R. Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), 135; Pothier, *op. cit.*, n° 67; Kames, *op. cit.*, 12; Dixon, *op. cit.*, 5.

[86] C. 8.40.11; D. 46.1.36 (Paul); H. Grotius, *Introduction to Dutch Jurisprudence*, 3.3.31; J. à Sande, *Commentary on the Cession of Actions*, chapter 7, n° 12 (in *Opera Omnia Juridica Joannis et Frederici à Sande Jurisconsulti Clarissimorum* (Antwerp, 1674)); Marasinghe, "An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine I," (1976) 10 Valparaiso U. L. Rev. 45, 51-2. However, later writers thought it desirable that the rule should be relaxed, so as to allow a cession *after* payment: J. Voet, *op. cit.*, 46.1.30; Forsyth, "Suretyship," in R. Zimmermann and D. Visser, *Southern Cross: Civil Law and Common Law in South Africa* (1996), at 423. Voet notes (*loc. cit.*) that if the surety had a mandate from the principal debtor, then he could require a cession even after payment. However, since a surety could not be a mandatary for his co-sureties, he could not avail of this rule in pursuing them.

[87] D. 46.3.76 (Modestinus); Sande, *loc. cit.*

nonetheless be regarded as effective.[88] One author concluded from the fact that an actual assignment was required to aid the surety that the surety's right of subrogation in equity could not have derived from the Roman practice.[89]

The second institution of Roman law was the right of a subsequent mortgagee to pay off a prior mortgagee and succeed to his place as a prior mortgagee.[90] A purchaser of incumbered property enjoyed this right also if he paid off an incumbrancer.[91] This substitution was regarded as occurring upon payment by the subsequent mortgagee or purchaser. No express stipulation or assignment was required.[92]

These institutions were considered as separate until the sixteenth century, when Dumoulin conflated them in order to advance his argument that the surety need not request an assignment of the creditor's rights, but should be entitled to it by virtue of the mere fact of payment.[93] This was a critical juncture in the development of the surety's rights, and can be regarded as the birth of the modern doctrine of subrogation in French law.[94] Pothier identified the confusion which Dumoulin had made as being

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[88] Bartolus of Saxoferrato (1314-1357), *Commentaria in Digestum vetus, Infortiatum, Digestum novum*, at D. 46.3.76 (Modestinus) (entitled D. 46.3.75).

[89] Marasinghe, "An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine," (1976) 10 Valparaiso U. L. Rev. 45, 275, at 54, 298-9. He does state, at 54, that "if an explanation could be found to show how the doctrine of subrogation became capable of effecting an *ipso jure* succession to another's rights, it may then be possible to suggest that the *Cessio Actionum* of Roman jurisprudence could indeed be its predecessor." *Cf.* W.W. Buckland, *Equity in Roman Law* (1911), 53-4, who acknowledged that there was no cession *ipso jure* in classical Roman law, but stated that later doctrine had accepted the idea.

[90] C. 8.18.1; D. 20.4.11.4 (Gaius) (if the first mortgagee refused payment by a subsequent mortgagee, he was precluded from enforcing his mortgage); 20.4.12.9 (Marcian) (the only right of the subsequent creditor was to take the place of the first creditor if he paid him); 20.4.20 (Tryphoninus); 20.5.2 (Papinian) (a surety who had been sued obtained an order that the land mortgaged to the creditor should be mortgaged to him; a later mortgagee was entitled to buy out the surety on payment to the surety of the amount which he had paid the first creditor, together with interest); 20.5.5 (Marcian) ("When a second creditor has offered payment to the first and taken his place, he may rightly sell the property in virtue of the payment and loan"); Dixon, *op. cit.*, 12-17; Mestre, *op. cit.*, n°s 15-16; Marasinghe, *op. cit.*, 47-8, note 15.

[91] C. 8.10.19; D. 20.4.17 (Paul) ("A purchaser of mortgaged land from a debtor is protected to the extent to which the purchase price has reached the earlier creditor"); Dixon, *op. cit.*, 21-24; Mestre, *op. cit.*, n° 16.

[92] Dixon, *op. cit.*, 16; Marasinghe, *loc. cit.*

[93] Dumoulin, *Prima Lectio Dolana*, in *Oeuvres de Dumoulin* (1681 ed.), III, 387. See Mestre, *op. cit.*, n° 17; Dixon, *op. cit.*, 63:

> "There is not to be found a single passage in the Roman law which shows that the surety, on payment, was subrogated to the rights of the creditor by operation of law. Dumoulin, however, has maintained, against the opinion of all former jurists, that a debtor *in solido* [*i.e.*, liable jointly and severally], a surety, and generally all those who pay what they owe, with or for others, are thereby subrogated of right to the actions of the creditor, and without requiring subrogation. His reason is, that they ought always to be presumed to have only paid, subject to this subrogation which they had a right to demand, nobody being presumed to neglect and renounce his rights."

[94] See Mestre, *op. cit.*, n° 20.

erroneous, but felt that the result achieved was nonetheless a proper one.[95] In due course, the French Civil Code,[96] and other civil codes modelled on it, provided that the surety was, upon payment, substituted to the creditor's rights by operation of law.[97]

The practice of maritime insurance seems to have developed during the later middle ages. By the sixteenth century, it seems that it was recognised that where compensation was available to an insured in respect of a loss from a third party, the insurer, on paying the insured, enjoyed a right of recourse against the third party.[98] Although the origins of this right are obscure, they seem to have developed from practice, and owed nothing, either by way of derivation, or analogy to the surety's right to an assignment of the creditor's actions.[99]

The view taken here is that these three institutions were absorbed at different times into English law, whether by simple borrowing or by permeation through the customs of merchants.[100] The common law had long recognised the right of a surety to be indemnified by his principal.[101] *Magna Carta* had conferred on a surety for a crown debtor the right to use crown process to secure his reimbursement.[102] An Irish case at the end of the thirteenth century referred to a surety who had paid the crown being permitted to sue the principal by means of crown process in the Court of Exchequer.[103] Since the fifteenth century, it appears that equity recognised a surety's right to indemnification in the absence of an express

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[95] M. Pothier, *A Treatise on the Law of Obligations or Contracts* (translation, W.D. Evans, 1806), n° 280; Dixon, *op. cit.*, 64; Mestre, *op. cit.*, n°s 17-18.
[96] Article 1251.
[97] For an overview, see Murray, "Suretyship - Common Law and Civil Law Approaches," (1986) 91 Comm. L.J. 1, 27-32.
[98] P. Santerna, *Tractatus perutilis et quotidianus de assecurationibus et sponsionibus mercatorum à d. petro santerna lusitano j.c.* ("The very useful and everyday treatise on insurances and contracts of merchants by Doctor Petrus Santerna of Portugal, *jurisconsultus*") (1552), §§ 33-34.
[99] The insurer's right was described as one of recourse (*regressum*); there is no reference to a cession of actions.
[100] It may also be noted that W.T. Barbour (*The History of Contract in Early English Equity*, (1914) 4 Oxford Studies in Social and Legal History, 167) has advanced the theory that the fifteenth century chancellors imported principles from the canon law, applying a criterion of breach of faith. There is no doubt that the canon law acknowledged a surety's right to indemnification by the principal debtor: Bónis, "Les Sûretés Personnelles en Hongrie du XIIIe au XVIIIe Siècle," (1971) 29 Receuils de la Société Jean Bodin pour l'histoire comparative des Institutions 725, 739, refers to a decision from 1401 where the Pope ordered that a principal debtor should indemnify a surety.
[101] See, *e.g.*, Glanvill, *A Treatise on the Laws and Customs of the Kingdom of England* (late twelfth century; translation by J. Beames, 1812), 10.4, at 250. Such cases precede Glanvill's tract.
[102] (1215), chapter 9: "Neither we nor our bailiffs shall seize any land or rent for any debt, so long as the chattels of the debtor are sufficient to repay the debt; nor shall the sureties of the debtor be distrained so long as the principal debtor is able to satisfy the debt; and if the principal debtor shall fail to pay the debt, having nothing wherewith to pay it, then the sureties shall answer for the debt; and let them have the lands and rents of the debtor, if they desire them, until they are indemnified for the debt which they have paid for him, unless the principal debtor can show proof that he is discharged thereof as against the said sureties" (translation of W.S. McKechnie, *Magna Carta* (1914), 262).
[103] *Le Blond* v. *de Rupe* (1295) 1 Calendar of Justiciary Rolls of Ireland 16.

promise of indemnity.[104] In a rare reported decision from the fifteenth century,[105] Stillington C.[106] held that a co-debtor who was in effect a surety (as his fellow debtor had received the benefit of the contract) was discharged from liability when the creditor extended the time for payment by the principal debtor. It is an early expression of the now hackneyed rule that if a creditor gives time to the principal, the surety is discharged.[107] One of the explanations given for the rule in later times was that the surety was entitled at any time after the debt became due, to pay it and then to have recourse against the principal, either by personal action, or by way of subrogation, and if his potential recourse by way of subrogation was destroyed, he was discharged.[108] The Year Book report of this case refers to nothing approaching such an explanation. However, the decision does seem to offer circumstantial evidence of a recognition of a right of indemnification or subrogation.

Records exist to show that claims for indemnification were made by sureties to courts of equitable jurisdiction during the fifteenth and sixteenth century, even in cases where there had been no express promise of indemnity by the principal.[109] At least as far back as the middle of the sixteenth century, there are records of bills in the equity side of the Court of Exchequer, where sureties sought indemnity from the principal debtor for payments made as sureties to the crown.[110]

The earliest continuous chancery reports commence in the seventeenth century, and contain a number of cases where the chancellor ordered the indemnification of a surety,[111] or contribution from a co-surety, or where the creditor was required to assign a security held by him to the surety, upon payment.[112] There is an earlier case[113] on the pleas side[114] of the Court of Exchequer where the court granted to the

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[104] See, *e.g.*, a petition (E.C.P. XIX, 204) cited by Barbour, *op. cit.*, 135, which asked the Chancellor to consider how reason and conscience required that since the petitioner had become surety at the defendant's instance and on his behalf, the latter should discharge him. It is felt that it would be wrong to infer a factual promise of indemnification from this claim (as Barbour seems to do); it means no more than what it states: that reason and conscience required the defendant to indemnify the petitioner.

[105] (1468) Y.B. M. 9 Edw. IV, f. 41, pl. 26.

[106] The Bishop of Bath and Wells.

[107] Stillington C. here seems to have taken the view that in these circumstances, the creditor must be deemed to have elected to take the principal debtor as his sole debtor. *Cf. Brown* v. *Wright*, 7 T.B. Monroe 396; 18 Am. Dec. 190 (Ky. 1828).

[108] See section 7.14, *post*. It is also said that, as the surety is a favoured debtor, bound only to the terms of his contract, if there is any variation in those terms in a manner adverse to him (*e.g.* by improving the payment terms of the principal debtor), he may treat himself as discharged.

[109] See Barbour, *op. cit.*, at 165, quoting from a number of petitions.

[110] *Hychcok* v. *Dean of Norwich* (1568) E. 112/29/87; *Harris* v. *Dean of Exeter* (1558-72) E. 112/10/7, cited in W.H. Bryson, *The Equity Side of the Exchequer* (1973), 11 note 3. There were also two cases where the petitioner sought contribution towards the payment of debts to the Crown: *Whalley* v. *Mounson* (1553-4) E. 111/46-E; *Kirkham* v. *Taverner* (1554-8) E. 111/46-C (*op. cit.*, 10 note 2).

[111] *Ford v. Stobridge* (1632) Nelson 24; Viner, *Abridgement, tit.* "Surety (D.)."

[112] *Tuphorne* v. *Gilbie* (1629-30) 1 Rep. Ch. 39; *Waller* v. *Dalt* (or *Dale*) (1676 or 1677) Rep. *temp.* Finch 295; Dickens 8; 1 Eq. Ca. Abr. 90; 1 Ch. Ca. 276.

[113] *Anon.* (1582) Savile 30, pl. 72.

[114] The common law side.

surety for a tax collector the right to use crown process to recover the debt from the principal debtor. This is one of the earliest clear cases of subrogation in the English courts.[115]

The English courts of equitable jurisdiction seem to have long acknowledged the right of a subsequent incumbrancer to pay off a prior incumbrancer, and then to avail of his former priority in order to reimburse himself the amount which he had paid. This is usually reflected in the procedure used in foreclosure proceedings, which required all incumbrancers to be parties to the action, and gave a right of redemption to all persons with an interest in the property.[116] Furthermore, since at least the seventeenth century, the court of chancery exercised a jurisdiction to marshal assets, which routinely took the form of holding that one claimant was entitled to occupy the position of another claimant to enforce the rights of that other against a fund of assets against which the former could not claim in his own right. This doctrine seems to be an extension of the subrogation of purchasers and incumbrancers.[117] Indeed, marshalling seems to have been the most common instance of subrogation in the court of chancery in the eighteenth century. In the Court of Admiralty, since the end of the seventeenth century, there are reports of claims by masters who had paid the crew's wages, claiming to have been subrogated to the crew's lien. The claims failed, on the ground that the crew's lien was personal and untransferable.[118]

Since the eighteenth century at least, there are reports of cases in chancery where a payer lent money to a person under an incapacity, for instance an infant or a married woman. Such loans were not recoverable. However, the courts permitted recovery to the extent to which the money had been used to pay off creditors whose claims were enforceable.[119]

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[115] It was stated by Morison B. to be "the course of the court." However, the surety was not to be allowed to recover if the collector still owed sums to the crown. It is arguable that this is an application of the maxim "*nemo contra se subrogasse censetur.*" As to this, see section 2.2, *post*. This principle was to be extended to persons who paid off the debt even though they were not sureties of the debtor or co-debtors: *R.* v. *Sedgwick* (1702) Wightw. 6n.; *R.* v. *Clark* (1726) Bunb. 221; Comyns 388; *R.* v. *Walton* (1735) Wightw. 3n.

[116] See section 11.4.a, *post*.

[117] See, *e.g.*, *Anon.* (1679) 2 Ch. Ca. 4; *Culpepper* v. *Aston* (1682) 2 Ch. Ca. 115, 117; *Sagitary* v. *Hyde* (1687) 1 Vern. 455; *Sprignall* v. *Delawne* (1687) 2 Vern. 36; *Goree* v. *Marsh* (1690) 2 Freem. 113; *Mill* v. *Darrel* (1693) 2 Vern. 309. See further, *post*.

[118] *Anon.* (1696) Fortescue 230; *Holland* v. *The Money arising from the sale of the "Royal Charlotte"* (1767-8) Burrell 62, 76. It later came to be accepted that, if one obtained the prior leave of the court to pay off the seamen, one could be subrogated to their lien, effectively by the permission of the court. See, *e.g.*, *The "Kammerhevie Rosenkrants"* (1822) 1 Hagg. Adm. 62; *The "Duna"* (1861) 6 Ir. Jur. (n.s.) 358; 1 Mar. L.C. 159; 5 L.T. 217; *The "Cornelia Henrietta"* (1866) L.R. 1 A. & E. 51; *The "Petone"* [1917] P. 198; D.R. Thomas, *Maritime Liens* (1980), §§ 471-8, 482; D.C. Jackson, *Enforcement of Maritime Claims* (1985), 239; C. Mitchell, *The Law of Subrogation* (1994), 148.

[119] *Harris* v. *Lee* (1718) 1 P. Wms. 482; *Marlow* v. *Pitfeild* (1719) 1 P. Wms. 558; *Hutchinson* v. *Standley* (1776) Annual Register 117. It is interesting to note, however, that a similar result seems to have been achieved in some fourteenth century common law cases, without using any analogy of "standing in the shoes" of another creditor: see Ibbetson, "Unjust Enrichment in England before 1600," in E.J.H. Schrage (ed.), *Unjust Enrichment, The Comparative History of the Law of Restitution* (Comparative Studies in Continental and Anglo-American Legal History, Band 15, Berlin, Duncker & Humblot, 1995), at 121,

The earliest English cases which recognise an insurer's right of subrogation date from the eighteenth century. However, they seem to regard the insurer's right as being something quite commonplace.[120] One of the earliest cases dealt with an insurer's right to reprisal or prize moneys awarded to the owners of ships lost during periods of naval hostility.[121] The use of the word "subrogation" to describe the insurer's right seems to have occurred first in France and its colonies and former colonies, including Quebec, and then to have been adopted in the United States.[122] It later spread to England[123] and Ireland.[124]

The assimilation of the separate doctrines seems to have occurred in France, under the influence of Renusson.[125] American authors[126] and judges[127] adopted much of the civil law doctrine, though they grafted it onto the existing English chancery law, noting the similarities between the rules

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143, citing *Cheyne* v. *Abbot of Ychefelde* (1374) C.P. 40/453 m. 212, where a lender to a monk (who was regarded as civilly dead, and incapable of contracting) claimed, in an action against the *prior* of the monastery that the money paid had been used to pay for repairs to the abbey and food for the monks. Ibbetson, *loc. cit.*, comments that "it was sufficient to show that the money had come to the use of the house."

[120] In *Mason* v. *Sainsbury* (1781) 3 Doug. 61, Lord Mansfield had stated that the insurer's right to be put in the place of the insured was "the plainest equity that could be."

[121] *Randal* v. *Cockran* (1749) 1 Ves. Sen. 98.

[122] Early usages in common law American jurisdictions are *Peele* v. *Merchants' Insurance Co.*, 19 F. Cas. 98, 119 (D. Mass. 1822) *per* Story J. (the word is used in an odd sense, seeming to mean a type of agency: Story J. states that, after an abandonment which was not accepted by the insurer, the insurer could not be expected to repair the ship, as doing so would be an act inconsistent with the owner's supposed continued rights, unless the underwriters were to be deemed "subrogated owners"), *Aetna Fire Insurance Co.* v. *Tyler*, 16 Wendell 385; 30 Am. Dec. 90, 95 (N.Y. 1836) *per* Walworth C. ("This principle of equitable subrogation or substitution of the underwriters in the place of the assured, is recognized by every writer on the subject of insurance, and is constantly acted upon in courts of law as well as in equity") and *Varet* v. *New York Insurance Co.*, 7 Paige Ch. 560, 567 (N.Y. 1839) *per* Walworth C. Early American uses in the context of suretyship include *Warner* v. *Beardsley*, 8 Wendell 194, 201 (N.Y. 1831) *per* Walworth C. (speaking of the civil law), and *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588 (1837).

[123] Marasinghe, "An Historical Introduction to the Doctrine of Subrogation II," (1976) 10 Valparaiso U. L. Rev. 275, 285, is of the opinion that the first use in an English court (actually the Judicial Committee of the Privy Council) was in a Quebecois appeal, *Quebec Fire Insurance Co.* v. *St. Louis* (1851) 7 Moore P.C. 286.

[124] The earliest reported use of the word in the insurance context in Ireland seems to have been in *Andrews* v. *Patriotic Assurance Company of Ireland (No. 2)* (1886) 18 L.R. Ir. 355.

[125] Philippe de Renusson (1632-1699). See Mestre, *op. cit.*, n° 17, note 17.

[126] Notably, Joseph Story, in *Commentaries on Equity Jurisprudence* (4th ed., 1846), §§ 499, 636. Also, S.F. Dixon's work, already cited, and the later nineteenth century treatises, H.N. Sheldon, *The Law of Subrogation* (1st ed., 1882, 2nd ed., 1893) and G.E. Harris, *A Treatise on the Law of Subrogation* (1889).

[127] Principally, Kent C. See his judgments in *Cheesebrough* v. *Millard*, 1 Johns. Ch. 409, 414 (N.Y. 1815), *King* v. *Baldwin*, 2 Johns. Ch. 554, 562 (N.Y. 1817) and *Hayes* v. *Ward*, 4 Johns. Ch. 123, 132 (N.Y. 1819). See also *Warner* v. *Beardsley*, 8 Wendell 194, 199 (N.Y. 1831) *per* Walworth C. and *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588, 598, 601 (1837), where Parker J. and Tucker P. quoted with approval Pothier, *op. cit.*, n° 520.

applied in the two systems,[128] and the idea of a coherent doctrine seems to have been imported back into English law during the nineteenth and twentieth centuries.

1.6 Subrogation; whether a right or a remedy

It is traditional to speak of a right of subrogation; that is, to say that upon the payment of the debt of another party, or of a debt for which the payer and another are liable, or upon the application of money lent to the payment of a claim, the payer or lender is thereupon subrogated to the rights of the creditor who is paid off. It appears to follow from this theory that there can be no judicial discretion to "withhold" a finding that a party has been subrogated. A judge, in ruling on whether or not subrogation has taken place, is merely deciding an historical fact.[129] The most he could do would be to find that by reason of some factor rendering the payer or lender's case unmeritorious, subrogation had not taken place. Lord Denning M.R. stated in one case[130] that a court had a discretion to hold that an insurer had not been subrogated to an employer's right to sue its employees. However, this was an isolated comment, and was justifiably criticised as being a mere expression of dislike for the consequences of subrogation in that case.[131] There have also been *dicta* to the effect that "the equitable doctrine of subrogation will not be applied when its application would produce an unjust result."[132] In *Bankers Trust Company* v. *Namdar*,[133] Peter Gibson L.J. said

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[128] Story, *op. cit.*, § 636.

[129] In *In re Butler's Wharf Ltd.* [1995] B.C.C. 717, 724, Mr. Richard Sykes, Q.C., sitting as a deputy High Court judge, stated that "notions of equity and unjust enrichment" were irrelevant to the surety's entitlement to subrogation: "It is far too late to be considering whether it is just that subrogation should be permitted in the factual circumstances which exist in the present case: subrogation has become part of the armoury available to a surety when he has discharged the whole of the debt guaranteed." See also *In re Chipboard Products Ltd. (in liquidation)*, unreported, High Court, Barr J., 1984 No. 7316 P, 20th October, 1994 and *Bankers Trust Company* v. *Namdar*, unreported, Court of Appeal of England and Wales, 14th February 1997.

[130] *Morris* v. *Ford Motor Co. Ltd.* [1973] Q.B. 792, 807.

[131] R.P. Meagher, W.M.C. Gummow and J.R.C. Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 904: "There is much to be said for the principle that equity might, on equitable grounds, decline assistance for a party asserting subrogation, but the criteria mentioned by Lord Denning really reflect no more than a dislike for *Lister's* case and this does not appear properly open to him" (referring to *Lister* v. *Romford Ice and Cold Storage Co. Ltd.* [1957] A.C. 555, where the House of Lords held that an employer's insurer had been subrogated to the employer's right to indemnification from an employee against the employer's liability to a third party injured by the act of the employee).

[132] *Boodle Hatfield & Co.* v. *British Films Ltd.* [1986] P.C.C. 176, 183 *per* Nicholls J. In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 753, Lord Hutton seemed to restate this phrase as a *presumption* that subrogation will take place: "the doctrine of subrogation is to be applied unless its application would produce an unjust result." In *Wagner* v. *Elliott*, 95 Pa. 487 (1880), the court refused to hold that a surety had been subrogated to a certain right, apparently on the ground that it would be unduly harsh on a third party. The case was pleaded as praying for a "decree of subrogation," which the court evidently felt it had a discretion to withhold. See further on the case, section 7.10, *post*. *Cf. Acer* v. *Hotchkiss*, 97 N.Y. 395, 402 (1884) *per* Finch J.:

"Subrogation is an equitable remedy which the court allows in a number of differing circumstances to reverse the unjust enrichment of a party. The court has no general discretion whether to give the remedy, but does so in recognised circumstances which make it unconscionable for that party to deny the proprietary interest claimed by another party."[134]

It is felt that, in cases where subrogation was intended by the parties, or is taken to have been intended either because of the notoriety of application of the doctrine, or because of some other presumption, it should be regarded as a right, existing independently of any judicial determination. In such cases, among which those of insurers and sureties can normally be classed, subrogation does appear to be a right, and an invariable and automatic companion of payment.[135] In other cases, where no question of the intention of the parties occurs it is more easily seen as a remedy.[136] Recent English judicial comment has adopted this view.[137] One is tempted to compare the position of the constructive trust, the status of which has been a topic of some controversy, some regarding it as an institution of substantive law, others as a remedy.[138]

1.7 Structure of the following sections

This thesis argues that subrogation cannot be encapsulated into a single pattern, or even a set of coherent patterns. This view must inevitably influence the structure of the thesis. For instance, Mitchell's thesis is that all, or nearly all of the cases dealing with subrogation can be explained using an unjust

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"The doctrine of subrogation is a device to promote justice. We shall never handle it unwisely if that purpose controls the effort, and the resultant equity is steadily kept in view."

[133] Unreported, Court of Appeal of England and Wales, judgment delivered 14th February 1997.
[134] There is a similar passage in *Boscawen* v. *Bajwa* [1996] 1 W.L.R. 328, 335 *per* Peter Gibson L.J.
[135] Compare Dixon, *op. cit.*, 52, 78-80, 93-4, 178, who took the view that although the surety had an undoubted right of subrogation, it was a mere equity until such time as the surety obtained an actual assignment of the creditor's rights. However, he also describes the surety's right to demand a transfer of a security as being "an absolute charge during the existence of the debt" (at 96).
[136] *E.g.*, Mitchell, *op. cit.*, 3, 4. *Cf.* Dixon, *op. cit.*, 47, referring to subrogation as an "equitable remedy."
[137] *Bankers Trust Company* v. *Namdar*, unreported, Court of Appeal of England and Wales, 14th February 1997; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 747 *per* Lord Hoffmann. Lord Hoffmann seems to have placed more emphasis on the remedial role of subrogation than on the contractual right.
[138] Birks, *op. cit.*, 89, describes this debate as "unintelligible and infinitely damaging." In *Chase Manhattan Bank N.A.* v. *Israel-British Bank (London) Ltd.* [1981] Ch. 105, Goulding J. had to decide whether the existence of a constructive trust over moneys mistakenly paid was a provision of the substantive or procedural law of the State of New York. He decided that the payer's equitable interest arose as a matter of substantive law. However, he also said (128) that there was no occasion to draw a line between the two in that case. In *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669, 716, Lord Browne-Wilkinson seemed to show some receptivity to the remedial

enrichment analysis. It is therefore logical for him to classify cases according to the "unjust factor" which he thinks gave rise to the remedy in each case. That is also a classification which makes it difficult for the reader to locate material by subject-matter. As this thesis disputes the consistency of the topic, it is inevitable that different instances of subrogation will have to be considered separately. However, in chapters two and three, a survey is attempted of certain basic features which may be common to different categories of subrogation. Even here, it will be noted, generalisations tend to be hedged around with qualifications, and it is often necessary to give separate consideration to the different categories within a single section.

The second part of the thesis examines the broader classes of persons who may be entitled to subrogation: those who pay the debt of another, and those who lend money to assist in the payment of a debt. Here, the case law is disordered. The role of intention is disputed. Some cases may be ones of intention, some of the reversal of unjust enrichment. The internal structure of this part is somewhat closer to that used by Mitchell, as it attempts to isolate the reasons why subrogation occurred in each of the cases considered.

The third part of the thesis consists of a consideration of some of the more important individual categories of subrogation. No attempt is made at synthesis here, although comparisons are made where they seem apposite. The aspects of the individual categories generally considered in the third part are those which most resist assimilation.

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constructive trust. See also Lord Goff of Chieveley and G. Jones, *The Law of Restitution* (5th ed., 1998), 84-9.

CHAPTER 2

REQUIREMENTS FOR THE AVAILABILITY OF SUBROGATION

2.1 Payment

A party cannot be subrogated to the position of a creditor unless he has either paid the creditor or has parted with funds which have been used to pay the creditor. An illustration is provided by the case of *Coursolles* v. *Fookes*.[1] The plaintiff in that case was an execution creditor against certain lands. He succeeded in an action to impeach a first mortgage as a fraudulent conveyance. He failed in an action to have a second mortgage on the same land set aside. He then claimed that he had been subrogated to the position of the first mortgagee, lest the second mortgagee profit from his diligence at his expense (at a later date, no doubt the case would have been argued on the basis that the second mortgagee would otherwise have been unjustly enriched). The court held that he had not been subrogated to the priority of the first mortgage, as he had not paid money or given anything in satisfaction or extinction of a claim.[2]

Where a secured creditor re-financed its loan by entering into a guarantee for the debtor with a third party, using funds released through the giving of the guarantee to discharge the secured loan, and taking fresh security on the same property to secure its liability as surety (which turned out to be invalid), the surety was held not to have been subrogated to the benefit of the earlier, valid security (which it itself had held). The first problem was that the surety was claiming to have been subrogated to its own former rights. The second problem was that the surety had not provided the money to discharge the debt owed it by the debtor.[3]

However, it is comfortably established that payment need not be in money; the acceptance of anything by the creditor in satisfaction of the claim will suffice.[4] Payment is nonetheless sufficient for a discharge leading to subrogation if made in instalments.[5]

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[1] (1889) 16 O.R. 691.

[2] In any event, he was in effect claiming to have been subrogated to the priority of a void mortgage.

[3] *Bankers Trust Company* v. *Namdar*, unreported, Court of Appeal of England and Wales, 14th February 1997.

[4] The giving of a promissory note by a surety to the creditor has been held to be a sufficient payment to entitle the surety to sue the principal debtor for indemnification: *Barclay* v. *Gooch* (1797) 2 Esp. 571; *Cumming* v. *Hackley*, 8 Johns. 202, 206 (N.Y. 1811); *Reed* v. *Van Ostrand*, 1 Wendell 424; 19 Am. Dec. 529, 532 (N.Y. 1828) (*dictum, per* Savage C.J.); *Miller* v. *Howry*, 3 Penrose & Watts 374; 24 Am. Dec. 320, 322 (Pa. 1832); *McKenna* v. *Harnett* (1849) 13 I.L.R. 206; *Gore* v. *Gore* [1901] 2 I.R. 269. *Cf.* *Maxwell* v. *Jameson* (1818) 2 B. & Ald. 51; *Whelan* v. *Crotty* (1868) 2 I.L.T.S.J. 285; *Power* v. *Butcher* (1829) 10 B. & C. 329, 346-7 *per* Parke J. ("The giving of a security to pay is not equivalent to actual payment"); *Rodgers* v. *Maw* (1846) 15 M. & W. 444, 449; *Taylor* v. *Higgins* (1802) 3 East 169. In the latter case, it was held that a bond, being a mere obligation to pay, was not the equivalent of cash. A negotiable instrument might often be treated as such because otherwise, if the instrument were negotiated,

2.2 Necessity to show that the money paid was used to pay off a debt

If one regards subrogation in any particular case as being a restitutionary remedy, then it appears that one who claims it will have to undertake an identification process before he can make his claim.[6] He must show that the discharge of a debt is the exchange product of money with which he parted.[7] In the simplest case, where one pays money to the creditor of another, there is no difficulty in establishing that the payer has caused the debt to be paid off.[8] On a strict restitutionary theory, one might say that the process of identifying an enrichment received by the debtor at the expense of the payer is a simple one: the discharge of the debt is the enrichment received by the debtor, and this can be identified as the product of the money paid by the payer directly to the creditor. The payer can then claim restitution of the amount of this enrichment.[9] Since the case is so simple, ordinarily one would not dissect it so minutely. However, problems of identification may arise in two cases: first, where the payer lends money to the debtor, who then pays off a creditor, and secondly, where one's money is wrongfully taken, and the true owner wishes to identify its product so that he can claim it (traditionally, a "tracing claim").

If one holds that an identification and claiming exercise is always necessary in cases of subrogation, then, at least on Birks' view, subrogation is always a restitutionary remedy.[10] This is because Birks has argued that in any case where a tracing (*i.e.*, identification) exercise is carried out, the claimant's rights to the product of the exercise are always restitutionary, even if the initial right was a proprietary one.[11] This derives from Birks' view that a claimant with a right to trace has only a power to

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the acceptor or maker might be forced to pay a second time, to a new holder in due course. In *Fahey* v. *Frawley* (1890) 26 L.R. Ir. 78, it was held that the transfer of land by the surety to the creditor was equivalent to payment, if the creditor had been willing to accept it. Similar American cases were *Ainslie* v. *Wilson*, 7 Cowen 662; 17 Am. Dec. 532 (N.Y. 1827); *Bonney* v. *Seely*, 2 Wendell 481, 482 (N.Y. 1829); *Lewis* v. *Lozee*, 3 Wendell 79, 82 (N.Y. 1829); *Gilchrist* v. *Cunningham*, 8 Wendell 641, 644 (N.Y. 1832); *Rodman* v. *Hedden*, 10 Wendell 499, 501 (N.Y. 1833); *McCrea* v. *Purmort*, 16 Wendell 460, 475 (N.Y. 1836); *Clark* v. *Fairchild*, 22 Wendell 576, 584 (N.Y. 1840), *per* Cowen J.

[5] *Gilbert* v. *Dunn*, 218 Ga. 531; 128 S.E. 2d 739 (1962).

[6] Smith divides traditional "tracing" into two parts: first, a process of identifying a substitute for the original property; secondly, a claim made to that substitute. He calls the first step "tracing" and the second "claiming": *The Law of Tracing* (1997), generally, and in particular, 6-24.

[7] Mitchell, *op. cit.*, 39; Smith, *op. cit.*, 152-4; Birks, *op. cit.*, 96-8, 373-5.

[8] *Cf.* Mitchell, *loc. cit.*

[9] Birks, *op. cit.*, 93-8, 373-5.

[10] This is the view of Mitchell, *loc. cit.*

[11] Birks, "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 91-2. In "Restitution," [1996] All E.R. Annual Review 366, 371, he writes:

> "The right in the money at the end of the tracing chain is not the same right as the trustee [claimant] held at the head of that chain. At the head of the chain he was entitled to a claim in personam against a bank. At the end of the chain he was the owner of money paid into court by another bank. That is not a survival of a pre-existing proprietary right... The *Jones* right is a new right, raised in the form of a power by operation of law and later crystallised by the act of the

re-vest property in him. This power "is generated by the unjust enrichment of the alienee in order to effect restitution."[12] When value is traced into a new asset, a new right arises, to reverse the enrichment of the respondent.[13] As this right is created in order to effect the return of property to the claimant, Birks classifies it as restitutionary.[14] It may be noted that in an earlier work, Birks recognised an intention-based, consensual route to subrogation.[15]

However, where an intention-based theory applies, on one view, there may not be a need to prove that the money paid was used to discharge a debt.[16] If the payer can establish that it was a mutual intention that he should succeed to the position of an existing creditor, or that he paid in the expectation of receiving security, which has been disappointed, then it may be proper to hold that the debtor should not be permitted to deny that the payer's money paid off the debt. This presumption would be conclusive as against the debtor himself. It would operate against other creditors, subsequent to the one who was paid, unless they could prove that the prior creditor was paid with money from another source.[17] There is little case law on the point, which can perhaps be explained for two reasons. First, issues of identification have seldom arisen in cases where subrogation was at issue. Secondly, where identification has been an issue, the nature of the case may have been such that intention was not a realistic ground on which subrogation could be based.[18]

> power-holder. The raising of the power effects restitution or, more accurately, enables the power-holder to effect restitution, thus reversing an unjust enrichment of the other at his expense. Restitutionary in effect, the right cannot be explained in terms of any originating event other than unjust enrichment."

In "On taking seriously the difference between tracing and claiming," (1997) 11 T.L.I. 2, 10 note 45, the same author states that in some cases the law may vindicate a right of property born out of unjust enrichment, giving *Trustee of the Property of F.C. Jones & Sons (a firm)* v. *Jones* [1996] 3 W.L.R. 703 as an example.

[12] Birks, "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 92.

[13] *Ibid.*

[14] Birks, *Introduction to the Law of Restitution* (1985, rev. ed. 1989), 57-64. Also, Smith, *op. cit.*, 300.

[15] Birks, *op. cit.*, 390-3, stating that *Nottingham Permanent Building Society* v. *Thurstan* [1903] A.C. 6 can only be understood as turning on the payer's intention. Mitchell thinks that the decision is unjustifiable on a "proprietary base" theory, but can perhaps be justified on the ground that the parties' mutual intent would otherwise have been thwarted: *op. cit.*, 158.

[16] See also Smith, *op. cit.*, 152, note 82, who adopts Mitchell's categories of simple and reviving subrogation. He then states that

> "Simple subrogation is often considered to have a contractual basis. If it is explicable in terms of unjust enrichment, it arises from enrichment and deprivation which are not connected by tracing...."

[17] *Cf.* Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 244, observing that on one view a causal relationship between payment and discharge should be sufficient.

[18] In *Blackburn Building Society* v. *Cunliffe, Brooks, & Co.* (1882) 22 Ch. D. 61, the Court of Appeal held that a lender under an invalid contract of loan could enforce his loan in so far as the borrower had applied the funds in payment of valid debts. Lord Selborne L.C. stated on behalf of the Court: "that the burden of

In many cases where funds were advanced to finance a purchase or the discharge of an incumbrance, it is undisputed that the funds were in fact so used. In cases where the funds were misapplied or where the lender could not enforce his own claim or security, but claims to have been subrogated to the rights of creditors whom the borrower paid off, the lender may encounter more difficulty in establishing that his advance was used to pay off a particular debt.

An early decision which seems to have turned on this difficulty is *Hooper* v. *Eyles*.[19] A guardian borrowed money to pay off an incumbrance on an infant's estate, promising the lender to grant him a security for it. The guardian died before granting the security. The lender sought "satisfaction" out of the infant's estate, on the ground that his funds had been used to discharge the incumbrance on it. The Lord Keeper refused to grant such a decree, apparently on the ground that the lender could not be permitted to trace his advance into the payment of the incumbrance:

> "Without some contract or agreement, you cannot charge the land or follow the money, though invested in land, or applied to pay off the incumbrance."[20]

Nonetheless, the lender was granted a personal remedy. The guardian had paid out a greater amount in discharge of the infant's estate than she had received. The Court therefore decreed that an account should be taken of the balance accruing in favour of the guardian's estate, and that this amount should be raised out of the infant's estate, and applied in payment to the lender.[21]

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proving this lies on [the lender]; and that, in satisfying that burden they cannot have the benefit of the rule in *Clayton's Case* [*Devaynes* v. *Noble; Clayton's Case* (1816) 1 Mer. 572]." However, given that the initial contract of loan was invalid and could not be enforced, the issue of intention appears not to have been a realistic ground on which the lender could have claimed to have been subrogated. In *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, Millett L.J. did make use of a conclusive presumption of intention by a recipient to "keep a charge alive" in favour of a payer, thereby making subrogation possible in his view. However, this was *after* Millett L.J. had satisfied himself that the payment had been used to pay the debt.

[19] (1704) 2 Vern. 480; Eq. Ca. Abr. 262, pl. 5.

[20] He cited *Kirk* v. *Webb* (1698) 2 Vern. 404; Pre. Ch. 84, perhaps the earliest reported equitable tracing case. See Oesterle, "Deficiencies of the Restitutionary right to Trace Misappropriated Property in Equity and in U.C.C. § 9-306," (1983) 68 Cornell L. Rev. 172, 177 note 10. For a more modern authority illustrating the necessity of showing that the advance which one made was used to pay off an incumbrance, see *In re Watson's Estate* (1898) 33 I.L.T.S.J. 58 (note); "Marshalling of Securities," (1899) 33 I.L.T.S.J. 185 (in that case, the lender already had a mortgage on the property at the time of his advance, though its validity was later impugned - the lender advanced money to a borrower on the same day that the borrower paid off an earlier mortgage; Ross J. held that there was insufficient evidence to establish that the borrower had used the funds advanced by the lender to discharge the earlier mortgage, so the lender could not claim to have been subrogated to the position of the earlier mortgagee); *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769.

[21] In *Munster and Leinster Bank* v. *McCann* [1937] Ir. Jur. Rep. 40, 42, FitzGibbon J. cited this case (with *In re Leslie; Leslie* v. *French* (1883) 23 Ch. D. 552 and *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234) as authority for the proposition that "a stranger in interest acquires no lien by such an advance" (an advance to pay the purchase price of land under the Land Acts). However, one should

A lender failed in the far more recent case of *Parkash* v. *Irani Finance Ltd.*[22] for the same reason. In that case, a lender to a purchaser claimed to have been subrogated to the rights of a first chargee, whose charge had been paid off by the vendor at the time of closing the sale. The claim failed because there was no evidence that the money paid by the lender had been used to pay the charge.[23]

The payer may be able to establish that the money lent was used to pay a creditor by using accounts or other records. This occurred in *Boscawen* v. *Bajwa*.[24] In that case, a lender advanced funds to a prospective purchaser's solicitors on terms that the money was to be used to purchase the property, or otherwise to be returned to the lender. The purchaser had agreed to grant the lender a mortgage of the property after completion. The purchaser's solicitors paid the money to the vendor's solicitors. The vendor's solicitors placed the money in their client account, and then paid off an existing mortgage on the property, by paying an amount larger than the amount which had been paid to them by the purchaser's solicitors. The sale was never completed. Millett L.J., with whom the other members of the Court of Appeal agreed, held that the book-keeping records of the vendor's solicitors, though made after the payment, were evidence that those solicitors had appropriated the lender's advance to the discharge of the mortgage.[25]

In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[26] a lender had advanced funds to the manager of the holding company of a group. The manager procured the lender to advance an equivalent sum directly to the defendant company. The defendant company used the funds to pay off a secured creditor. The defendant company then issued a promissory note in favour of the manager, who assigned it to the lender. On those facts, Lord Hoffmann (with whom a majority of members of the House of Lords sitting agreed) held that there was no difficulty in showing that the lender's money had been applied to pay off the secured creditor, even though the loan had notionally been made to the manager rather than the defendant company itself.[27]

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compare *Bank of Ireland Finance Ltd.* v. *D.J. Daly Ltd.* [1978] I.R. 79; *Highland Finance Ireland Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1998] 2 I.R. 180, affirming [1992] 1 I.R. 472. Note also *Red River State Bank* v. *Reierson*, 533 N.W. 2d 683 (N.D. 1995); [1996] Rest. L. Rev. § 314, note by Kull.

[22] [1970] Ch. 101.

[23] It would appear that the lender would have been well advised to have sought discovery of the vendor's bank records.

[24] [1995] 4 All E.R. 769.

[25] In a rather similar case, *Penn* v. *Bristol and West Building Society* [1995] 2 F.L.R. 938, the court seems to have been readily satisfied that money lent had been used to pay off a mortgage, not finding it necessary to discuss the matter.

[26] [1998] 1 All E.R. 737.

[27] [1998] 1 All E.R. 737, 748. Lord Hoffmann noted that the case was in that respect stronger than *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769. The fact that there were differences in the contracts of loan between the lender and the manager and the manager and the defendant company was immaterial.

In the absence of direct evidence, where money is paid into an active current account, a court may apply the rule in *Clayton's Case*,[28] which is a presumption of the intentions of debtor and creditor, in the absence of evidence of a contrary intention, that payments made out of such an account will be presumed to have taken place in the same order as payments made in.[29] In other words, first in, first out. This has been applied in a series of cases involving the claim of a lender to a company or its liquidator to have been subrogated to the preferential claims of employees for wages.[30] To evade the arbitrary results of this rule, banks will usually open a wages account if a company faces difficulties, and debit wage cheques against this account, while crediting lodgments to the company's other accounts.[31]

Some authors have suggested that the decision in *Barlow Clowes International Ltd. (in liq.)* v. *Vaughan*[32] indicates that the courts may adopt a more flexible approach in identifying the eventual application of an advance.[33] That case is not, however, one where a lender attempted to prove that his advance had discharged a liability of the borrower. Rather, the Secretary of State for Trade and Industry had made compensation payments to investors in failed schemes operated by the company. In return for these payments, the investors had subrogated the Secretary by contract to their previous claims against the company. The difficulty arose in identifying the investors to whose deposits the remaining assets were attributable. Rather than applying the rule in *Clayton's Case*, or the "rolling charge" method,[34] the Court of Appeal held that the Secretary should recover *pari passu* in respect of each investor.[35] The decision

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[28] *Devaynes* v. *Noble; Clayton's Case* (1816) 1 Mer. 572.

[29] Against the use of *Clayton's Case* is a curious *dictum* of Lord Selborne L.C. in *Blackburn Building Society* v. *Cunliffe, Brooks, & Co.* (1882) 22 Ch. D. 61, 71. See also *In re Birkbeck Permanent Benefit Building Society* [1912] 2 Ch. 183, 198 *per* Neville J.; *In re M.J. Cummins Ltd. (in vol. liq.); Barton* v. *Bank of Ireland* [1939] I.R. 60, 61, 62. Note Birks, "Persistent problems in misdirected money: a quintet," [1993] L.M.C.L.Q. 218, 219: "Such is the nature of *Clayton's Case*: it allows the tracing exercise to cope with the seeming impasse of a solera problem - a bank account or other fund which, like a barrel of madeira, has constantly been drawn off and topped up; but the firmness of its answer is paid for in brutally abrupt discrimination within a queue of similar claimants." See generally, L.D. Smith, *The Law of Tracing* (1997), 189-194.

[30] See *In re Primrose (Builders) Ltd.* [1950] 1 Ch. 561; *Station Motors Ltd. (in vol. liq.)* v. *Allied Irish Banks Ltd.* [1985] I.R. 756.

[31] *Cf. In re E.J. Morel (1934) Ltd.* [1962] Ch. 21, where this system failed. Where a lender has advanced funds to meet both preferential and non-preferential claims, and holds security for all of his advances, he is entitled to appropriate the proceeds of the security to the non-preferential claim: *In re William Hall (Contractors) Ltd.* [1967] 2 All E.R. 1150. By contrast, where set-off operates by statute, the creditor cannot "appropriate" the claim to be set off against his own non-preferential claims. It now appears that the set-off will operate rateably against the preferential and non-preferential claims: *In re Unit 2 Windows Ltd.* [1985] 3 All E.R. 647.

[32] [1992] 4 All E.R. 22.

[33] Goff and Jones, *op. cit.*, 109; Mitchell, *op. cit.*, 40; R.A. Pearce and J. Stevens, *The Law of Trusts and Equitable Obligations* (1995), 527-8. See also H. Delany, *Equity and the Law of Trusts in Ireland* (2nd ed., 1999), 640-1; Smith, *op. cit.*, 267-270.

[34] Under which a debit to a particular account at a particular time would be apportioned rateably among each of the depositors to that account; see *In re Ontario Securities Commission and Greymac Credit Corp.* (1986) 55 O.R. (2d) 673.

[35] This was stated to be similar to the apportionment of assets between depositors and shareholders in *Sinclair* v. *Brougham* [1914] A.C. 398.

appears to have been a pragmatic one, motivated by the difficulties in unravelling the multiple transfers of funds, and one may doubt whether the approach will find favour in less complex situations.

Where the payer is able to show that a person who received payment and mixed it with other funds did so in a fiduciary capacity, a series of presumptions or "tracing rules" will become available to help him in the identification process.[36] The traditional view has been that the equitable tracing rules are available only where the recipient occupied a fiduciary position with regard to the payer.[37] If the recipient did not receive the money in a fiduciary capacity, then it seems that, at least in theory, the payer should still be able to trace his payment, at least for the purpose of establishing the eventual product of the money.[38] This does not mean that he would necessarily be entitled to assert a proprietary remedy over the product.

Aside from *Boscawen* v. *Bajwa*,[39] no court seems to have recognised the fiduciary requirement as a prerequisite to subrogation in any context. It seems that the better view is that a payer who could not show that the recipient occupied a fiduciary position with regard to him should still be entitled to trace his payment,[40] but the rules which establish presumptions in favour of beneficiaries as against fiduciaries would not apply. Smith asserts that these rules are rules of *identification* of substitutes of property, and that they apply at common law as well as in equity to wrongdoers of types other than fiduciaries.[41] The rules will be set out briefly in traditional form:[42]

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[36] Goff and Jones, *op. cit.*, 105-114.

[37] *In re Diplock's Estate; Diplock* v. *Wintle* [1948] Ch. 465. This supposed requirement is the subject of sustained attack by Smith, *op. cit.*, 120-130. A fiduciary relationship has sometimes been easily established, however: it has been held that a recipient of a mistaken payment is a fiduciary with respect to the payer: *Chase Manhattan Bank N.A.* v. *Israel-British Bank (London) Ltd.* [1981] Ch. 105; *O'Brien* v. *O'Brien*, unreported judgment, Costello J., 18th October, 1983, 1983 No. 4110 P (I am indebted to Mr. Nicholas Butler, Barrister, for supplying me with a copy of the judgment in the latter case). The conclusion in *Chase Manhattan* that money paid under a mistake was held on constructive trust was attacked by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669, 714-5, who was, however, prepared to concede that such a trust might have arisen as soon as the recipient became aware of the mistaken payment. See also Delany, *op. cit.*, 644-7. Pearce and Stevens, *op. cit.*, 534, offer the view that criticism of the requirement has been over-stated, as there has seldom been a difficulty in establishing a fiduciary relationship. If Smith is correct, and similar rules are available at common law, where, for historical reasons, there could have been no such fiduciary requirement, then it makes little sense for a precondition to be imposed on the same process in equity.

[38] One modern critical view is that the use of the tracing process should not be dependent on a fiduciary relationship. However, the nature of the claim which the payer may make to the end-product of the tracing exercise *may* depend upon the establishment of a fiduciary relationship: Smith, *op. cit.*, 340 *et seq.*

[39] [1995] 4 All E.R. 769.

[40] *Cf. Dublin Corporation* v. *Building and Allied Trades Union*, unreported judgment, Budd J., 6th March, 1996, at 41, reversed, without reference to this point, [1996] 2 I.R. 468.

[41] *Op. cit.*, 194-215. Goff and Jones, *op. cit.*, 103 *et seq.*, deal with the rules under the heading of "identification," but then interchange this with language which speaks in terms of claiming.

[42] For greater elaboration, see Goff and Jones, *op. cit.*, 105-114.

(i) where a trustee or other fiduciary mixes the beneficiary's money with his own, the beneficiary should have prior claim over the mixed fund; in this regard, the trustee will be presumed to have dissipated his own portion of the mixed fund before that of the beneficiary;[43]

(ii) where the fiduciary has mixed the moneys of two beneficiaries, they should share the fund *pari passu*, unless the mixed funds have been lodged to the credit of an active, unbroken banking account, in which case, the rule in *Clayton's Case* applies *inter se*; the claims of any beneficiary take priority over that of the fiduciary himself;[44]

(iii) a *bona fide* transferee for value without notice of the beneficiary's interest will take priority over the beneficiary;[45]

(iv) a volunteer without notice will hold the fund subject to the claim of the beneficiary;

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[43] *In re Hallett's Estate* (1880) 13 Ch. D. 696, where Jessel M.R. and Baggallay L.J. held that the rule in *Clayton's Case* should not apply to govern the order of appropriation of *trust funds*. Rather, the trustee or fiduciary holding them must be taken to have first used his own funds to pay debts incurred for his own purposes, and to have reserved the trust funds till last. Thesiger L.J. dissented. See Goff and Jones, *op. cit.*, 106-7; Oesterle, *op. cit.*, 207, note 66. However, if the money first drawn out was preserved, and that which remained dissipated, the trustee would be taken to have dissipated his own funds: *In re Oatway* [1903] 2 Ch. 356. See now *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 403-4 *per* Scott V.-C., who also noted that the beneficiary could alternatively claim to have a charge over the product of the commingled fund in order to recover his funds plus interest. He described this as a restitutionary remedy. Later in his judgment (at 408), Scott V.-C. stated that where trust funds were used by a trustee in the improvement or enhancement of his own property, the beneficiary would undoubtedly be entitled to a charge to reimburse himself, but would only be entitled to a *pro rata* share in the value of the property (on the basis of a constructive trust) if he could show that the use of his funds had increased the value of the property. In *Hart* v. *Ten Eyck*, 2 Johns. Ch. 62, 108 (N.Y. 1816), Kent C. said that "[i]f a party having charge of the property of others, so confounds it with his own, that the line of distinction cannot be traced, all inconvenience of the confusion is thrown upon the party who produces it, and it is for him to distinguish his own property or lose it." Some American courts have applied a rule that, if a fiduciary mingles his own funds with those of a beneficiary, and then pays premiums on a policy on his own life with those funds, the burden of proof is on the fiduciary to show that the premiums were not paid with the beneficiary's money: *Succession of Onorato*, 219 La. 1, 32; 51 So. 2d 804, 814; 24 A.L.R. 2d 656 (1951). This can effectively work in the opposite way to the presumption stated in the text: the fiduciary may pay premiums using the first funds to be withdrawn, leaving a balance in the commingled fund. Under the rule stated in the text, it would be presumed that the fiduciary used his own funds to pay the premiums, and that the balance in the fund represented the beneficiaries' money.

[44] See also *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 404 *per* Scott V.-C. As to the application of the rule in *Clayton's Case* to lodgments to the credit of an active, unbroken banking account (*e.g.*, a current account), see *In re Hallett's Estate* (1880) 13 Ch. D. 696; *In re Hughes, A Bankrupt* [1970] I.R. 237, 243. If moneys have been lodged to any other form of account, such as a deposit account, the loss must be borne *pari passu*. See Goff and Jones, *op. cit.*, 108-9. However, the circumstances may be such that the claim of one beneficiary may be regarded as superior to that of others, thereby entitling that claimant to repayment ahead of other beneficiaries, who might share the balance of the funds *pari passu* as between themselves: *In re Money Markets International Stockbrokers Ltd. (in liq.)*, unreported judgment, Laffoy J., 20th July 1999, 1999 No. 32 Cos., at 14-15. However, the account there was a current one, and Laffoy J. accepted that it was settled law that *Clayton's Case* applied *unless* displaced, as on the ground that it did not accord with the intention or presumed intention of the beneficiaries of the trust funds. However, the claimant beneficiary under consideration in that judgment was entitled to succeed on the facts even if *Clayton's Case* applied, and therefore, Laffoy J. seems not to have decided whether there was any factor present which displaced the rule in *Clayton's Case*.

(v) if an innocent volunteer mixes his money with that of the beneficiary, the commingled fund should be apportioned *pari passu*.[46]

In *Boscawen* v. *Bajwa*,[47] as has been seen, the payer was able to prove that his money had paid off a mortgage, without recourse to tracing rules or presumptions. The Court of Appeal nonetheless seemed to regard it as a prerequisite of the payer's claim that he should establish that the initial recipient occupied a fiduciary position with regard to it.[48] There was no difficulty in that on the facts of the case, so the court did not dwell on the point. As the application of the payer's money had been proved, it would have been preferable if the court had treated the fiduciary relationship as immaterial *for the purposes of tracing* the payer's money. However, it did not feel free to do so.[49]

The competing creditors of the purchaser also argued that, for the purposes of the tracing rules set out above, the purchaser had to be treated as an innocent volunteer who had mixed trust funds of the payer with his own. Millett L.J. held that the owner was not an "innocent volunteer" within the meaning of the tracing rules. The owner knew that the funds advanced were not for his own use, and that he could only be entitled to the balance of the purchase price after deduction of the amount due on his mortgage. Millett L.J. also held that where trust funds had been applied in discharging an incumbrance on property, there was no legal impediment to holding that the beneficiary had been subrogated to the position of the incumbrancer.[50]

2.2.a Whether Lender can trace into the discharge of a debt

In *In re Diplock's Estate; Diplock* v. *Wintle*,[51] the Court of Appeal held that even if a claimant could show that money belonging to it was used by the recipient to discharge a liability which it owed to a third party (*i.e.*, even if it had a proprietary right in the money), still it could not claim to have been subrogated to the third party's rights against the recipient. The Court stated[52] that the effect of the payment had been to extinguish the debt which the recipient owed to the third party. Although this

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[45] Goff and Jones, *op. cit.*, 110.
[46] Goff and Jones, *op. cit.*, 109-110. It appears from both *In re Diplock's Estate; Diplock* v. *Wintle* [1948] Ch. 465, 547-8 (*per* Lord Greene M.R.) and *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 404 (*per* Scott V.-C.) that where trust funds are used in the improvement of property belonging to an innocent third party, the beneficiary may not be entitled to any charge over the property unless an increase in the value of the property can be shown. If an increase could be shown, Scott V.-C. stated ([1997] 3 All E.R. 392, 404) that "[i]t may be that in some circumstances the restitutionary remedy of a charge over the property would be available to the beneficiaries."
[47] [1995] 4 All E.R. 769.
[48] [1995] 4 All E.R. 769, 777.
[49] [1995] 4 All E.R. 769, 777.
[50] [1995] 4 All E.R. 769, 782-3. Thus, he disapproved of a passage in the judgment in *In re Diplock's Estate; Diplock* v. *Wintle* [1948] Ch. 465, 549-550. See the next section.
[51] [1948] Ch. 465, affirmed [1951] A.C. 251, *sub nom. Ministry of Health* v. *Simpson*.

statement has recently been approved in Ireland[53] and England,[54] the Court of Appeal in *Boscawen* v. *Bajwa* has recently stated that it should no longer be followed.[55]

A lender may be subrogated to the benefit of claims which were paid off using his advance even if the claim only arose after the time of the loan.[56] In relation to the converse situation, there are, however, *dicta*[57] which suggest that tracing is impossible if the claim of the third party was paid prior to the receipt of the funds which are being traced. These cases did not refer to the earlier authorities in the context of subrogation, and in any event, more recent judicial comment[58] has left the question open.[59]

2.3 Whether Creditor must have been paid in full

It is immaterial that the creditor has not been paid in full by the party seeking subrogation, as long as he has accepted payment in full satisfaction from some party or parties.[60] In the United States and

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[52] [1948] Ch. 465, 549.

[53] *P.M.P.A.* v. *P.M.P.S.*, unreported judgment, Murphy J., 27th June, 1994, noted [1995] Rest. L. Rev. § 217 by O'Dell, and by Delany, *op. cit.*, 641-2.

[54] *Bishopsgate Investment Management Ltd. (in liq.)* v. *Homan* [1995] Ch. 211; *In re Goldcorp Exchange Ltd.* [1995] 1 A.C. 74 (Privy Council on a New Zealand appeal); *Box* v. *Barclays Bank p.l.c.*, unreported judgment, Ferris J., High Court, England and Wales, 24th March 1998, noted [1999] Rest. L. Rev. § 105; (1998) 10 Credit and Finance Law 37, 38. Those cases concerned payments into an overdrawn bank account. The courts took the view that there could be no tracing beyond that point, as the funds had "ceased to exist."

[55] [1995] 4 All E.R. 769, 782 *per* Millett L.J., observing that the discharge of a debt is usually a precondition to subrogation. See also *In re Birkbeck Permanent Benefit Building Society* [1912] 2 Ch. 183, where Neville J. held that in so far as *ultra vires* depositors with the society (effectively lenders) could trace their deposits into the discharge of debts of the society, they could claim reimbursement, apparently *pari passu* with the ordinary creditors. However, as the society had not kept separate accounts for the depositors, this was impossible to do. The decision on this point was not appealed.

[56] *Baroness Wenlock* v. *River Dee Company* (1889) 19 Q.B.D. 155, approved by Porter M.R. in *In re Lough Neagh Ship Co.; Ex parte Workman* [1895] 1 I.R. 533, 542. See also *In re Birkbeck Permanent Benefit Building Society* [1912] 2 Ch. 183, 231-2 *per* Buckley L.J.

[57] *James Roscoe (Bolton) Ltd.* v. *Winder* [1915] 1 Ch. 62; *In re Goldcorp Exchange Ltd. (in receivership)* [1995] 1 A.C. 74; *Bishopsgate Investment Management Ltd. (in liq.)* v. *Homan* [1995] Ch. 211, 221 *per* Leggatt L.J.

[58] *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 409 *per* Sir Richard Scott V.C. However, in the same case (at 421) Morritt L.J., who dissented (though that may not be material as regards what is in any event *obiter*), expressed approval of the comments of Leggatt L.J. in *Bishopsgate Investment Management Ltd. (in liq.)* v. *Homan* [1995] Ch. 211, 221.

[59] Smith, "Tracing into the Payment of a Debt," (1995) 54 C.L.J. 290, 292-5 sees no objection to this form of tracing. See also *Agricultural Credit Corporation of Saskatchewan* v. *Pettyjohn* (1991) 79 D.L.R. (4th) 22.

[60] *Gedye* v. *Matson* (1858) 25 Beav. 310, 312; *Drew* v. *Lockett* (1863) 32 Beav. 499; *Equity Trustees Executors Agency Co.* v. *New Zealand Loan and Mercantile Agency Co.* [1940] V.L.R. 201; *A.E. Goodwin Ltd. (in liq.)* v. *A.G. Healing Ltd. (in liq.)* (1979) 7 A.C.L.R. 481; *McColl's Wholesale Pty. Ltd.* v. *State Bank of New South Wales* [1984] 3 N.S.W.L.R. 365; *Russet Pty. Ltd. (in liq.)* v. *Bach*, Supreme Court of New South Wales, Equity Division, Hodgson J., 23rd June 1988, 1988 N.S.W. LEXIS 9434; BC 8801811, at 12; *Raffle* v. *A.G.C. (Advances) Ltd.*, Supreme Court of New South Wales, Equity Division, Young J., 13th September 1989, 1989 N.S.W. LEXIS 11250; BC 8901727; *Macedone* v. *Collins*,

civil law jurisdictions, it seems almost universally to be held that before a payer can be subrogated, the creditor must have been paid in full, or accepted payment of part in satisfaction of the whole.[61] The civil law recognizes a general principle, sometimes expressed by the maxim *nemo contra se subrogasse censetur*: no-one is deemed to have subrogated against himself. The meaning of this is that a person who claims to have been subrogated to the rights of a creditor cannot claim against the debtor until such time as the creditor has received payment of his claim in full. The subrogated party is not allowed to compete with the creditor.[62] The maxim generally has the effect only of a presumption: the creditor may allow a subrogated party to compete with him against the debtor. Harris states that the principle found its origin in the Code of Justinian.[63] In civil law systems, the principle is still applied at the present day.[64] The common law as applied in Ireland and England does not appear to recognise a general principle to this effect.[65] However, it appears to be accepted in some contexts, though not expressed to be a principle. Certainly, little or no attempt has been made to adumbrate a rule of general application. By contrast, it is frequently applied as a rule in the United States.

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unreported, Court of Appeal of New South Wales, 20th December 1996, 1996 N.S.W. LEXIS 3856; BC 9606684, at 56 *per* Beazley J.A. In *In re Fenton, Ex parte Fenton Textile Association* [1931] 1 Ch. 85, Lawrence L.J. said, *obiter* (at 115): "Even where the principal creditor has been paid in full partly by a dividend from the estate of the insolvent surety and partly by a dividend from the estate of the insolvent principal debtor, the trustee of the insolvent surety will not be allowed to prove against the estate of the principal debtor for the amount which the estate of the surety has contributed towards the payment of the debt, as it is only when the surety has paid the full amount of the debt that he will be subrogated to the rights of the principal creditor," referring to *In re Oriental Commercial Bank* (1871) L.R. 7 Ch. 99, 102. No similar statement is to be found in the latter case, which is an example of the application of the rule against double proof, as indeed was *Fenton*. Lawrence L.J. was correct in his conclusion on the facts before him: if the surety's trustee had been allowed to prove, it would have been a second proof. However, if Lawrence L.J. meant to state any broader principle, he was wrong. A statement by Lord Templeman, speaking on behalf of the Privy Council in *China and South Sea Bank Ltd.* v. *Tan* [1990] 1 A.C. 536, 545, seems to suggest that the claimant must himself have paid the entire debt, but the point did not arise in that case, and the statement was therefore *obiter*.

[61] *Camden County Welfare Board* v. *Federal Deposit Insurance Corporation*, 1 N.J. Super. 532; 62 A. 2d 416, 427 (1948); *Schmid* v. *First Camden National Bank*, 130 N.J. Eq. 254, 266; 22 A. 2d 246 (Ch. 1941). See 11 U.S.C. § 509 (c); *In re Valley Vue Joint Venture*, 123 B.R. 199, 208; 21 Bankr. Ct. Dec. 513; 13 U.C.C.R. Serv. 2d (Callaghan) 842 (Bkrtcy. E.D. Va. 1991).

[62] J. Mestre, *La Subrogation Personnelle* (1979), states, at § 568, n. 2, that the maxim was referable only to cases of partial payments. While M. Pothier, *Coutumes des Duché, Baillige et Prévoté d'Orléans, et ressort d'iceux*, n° 87 (in M. Dupin (ed.), *Oeuvres de Pothier*, X (1827)), stated broadly that "subrogation can never be in opposition to nor prejudicial to the subrogating creditor," he still only applied the maxim to cases of partial payments.

[63] Harris, *op. cit.*, § 28, referring to C. 1.18.8.

[64] Modern civil codes tend to state that the creditor shall not be prejudiced by subrogating another party. This may be influenced by the notion that the granting of subrogation by a creditor is something of a benevolent dispensation by the creditor: he should not be injured by his act. See the French Civil Code, Article 1252: "[s]ubrogation cannot harm a creditor when he has only been paid in part; in this case, he can exercise his rights for what remains due to him, in priority to the person from whom he has received only a part payment." Mestre, *loc. cit.*, refers to other similar provisions: Civil Code of Quebec, Article 1157; Civil Code of Spain, Article 1213; Civil Code of Cuba, Article 1213. By contrast, the Italian Civil Code provides to the contrary, at Article 1205: "if the payment is partial, the subrogated third party and the creditor have concurrent rights against the debtor, in proportion to what is due to them, in the absence of an agreement to the contrary."

2.3.a Basis for the rule

A number of explanations for the rule have been advanced by French writers.[66] One rested on the presumed will of the creditor: the creditor was to be presumed to have consented to subrogation only on the condition that doing so would not harm him. He was therefore deemed to have reserved priority for himself as against the subrogated claim of the payer.[67] Another proposed justification was that the rule was based on equity. While equity allowed the subrogation of the payer, equally, it required that the position of the creditor should not be harmed. Mestre felt that it was unclear why this was a more equitable solution than allowing the payer and creditor to claim from the debtor in proportion to what each was owed.[68]

Mestre's preferred solution was to say that it was irrelevant to the creditor whether he was paid by the debtor, who could not claim subrogation, or by some other person, who could. As far as the *creditor* was concerned, partial payment from a third party extinguished so much of the debt, but as regards the third party, he had a right which could be exercised once the creditor had been fully satisfied.[69] If this view was correct, and the maxim was intended to protect the creditor's position, it followed that the creditor could waive this privilege.

2.3.b Application of the rule in common law jurisdictions

It seems that one cannot say that any definite doctrine exists Ireland or England analogous to that in the civil law. Harris, writing of the American law in 1889, felt that a similar rule existed there, derived from the civil law, justified by the desire to protect the original creditor.[70] Similar views have repeatedly been expressed by American courts, fearful that any alternative might hinder the creditor in the recovery

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[65] To the contrary is Mitchell, *The Law of Subrogation* (1994), 41.
[66] See Mestre, *op. cit.*, § 570.
[67] Mestre, *loc. cit.*, citing M. Pothier, *Traité de l'hypothèque*, § 153; P. de Renusson, *Traité de la Subrogation de ceux qui succèdent en lieu et place des créanciers* (2nd ed., Paris, J.-A. Sérieux) (1780), quoted in Mestre, *loc. cit.*, n. 5. This was a widespread view. Voet, *Commentary on the Pandects*, 46.1.27, thought that it would be absurd to require a part cession to a surety who paid a part of the debt.
[68] *Op. cit.*, § 572.
[69] Renusson had expressed a rather similar view:

> "the creditor who has not been fully paid remains such for what remains due to him, and always retains this position until he has been fully paid. The new subrogated creditor cannot say that he has succeeded to his place and position, because the old creditor himself occupies and fills the position of creditor. He is not deemed to have left it and ceded it to another until he has fully been paid his due."

(*Op. cit.*, at chapter XV, n° 2, cited in Mestre, *op. cit.*, § 573, n. 15).

of his debt.[71] However, it seems to be accepted in the United States that the payer and creditor may agree to vary this rule, and permit the payer to enforce his rights before the creditor has been paid in full.[72]

2.3.c Application in cases of Suretyship

In the United States, the rule stated above is applied.[73] In Ireland and England, the rules in relation to suretyship are tangled.[74] A surety can certainly not claim to have been subrogated until he has paid the entire amount for which he is liable.[75] However, it seems that he may claim to have been subrogated even where the creditor has not been paid in full, if his undertaking is understood to have been

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[70] G.E. Harris, *A Treatise on the Law of Subrogation* (1889), § 29. The author's process of thought is characteristically opaque, however.

[71] *White* v. *Nationwide Mutual Insurance Co.*, 361 F. 2d 785, 787 (4th Cir. 1966); *Travelers Insurance Company* v. *Commercial Union Insurance Company*, 335 S.E. 2d 681 (Ga. App. 1985); *Cherokee Insurance Company* v. *Lewis*, 371 S.E. 2d 103, 105 (Ga. App. 1988). See generally, *Cleary Brothers Construction Co.* v. *Upper Keys Marine Construction, Inc.*, 526 So. 2d 116, 117 (Fla. 3rd D.C.A. 1988).

[72] See *Morrow* v. *United States Mortgage Co.*, 96 Ind. 21 (1884), and other cases referred to by A.A. Stearns, *The Law of Suretyship* (5th ed., 1951, by J.L. Elder), § 11.16, note 55. As to provisions for subrogation in insurance policies, see *post*.

[73] See Harris, *loc. cit.*; *Kyner* v. *Kyner*, 6 Watts 221 (Pa. 1837); *Cottrell's Appeal*, 23 Pa. 294, 295 (1854). *Cf. Williams* v. *Tipton*, 5 Humph. 66; 42 Am. Dec. 420, 421 (Tenn. 1844) *per* Reese J.: "to the extent to which the complainant [surety] has satisfied the judgment of the creditor, he has a right to be substituted to such judgment creditor..." More recent authorities are *United States Fidelity & Guaranty Co.* v. *Centropolis Bank of Kansas City, Missouri*, 17 F. 2d 913, 917; 53 A.L.R. 295 (8th Cir. 1927) ("It is a familiar principle of the law of subrogation that a surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied."); *Mellette Farmers' Elevator Co.* v. *H. Poehler Co.*, 18 F. 2d 430, 431 (D. Minn. 1927); *Phifer State Bank* v. *Detroit Fidelity and Surety Co.*, 97 Fla. 538, 543-4, 121 So. 571, 573 (1929); *Whyel* v. *Smith*, 101 Fla. 971, 975; 134 So. 552, 554 (1931); *Ulery* v. *Asphalt Paving, Inc.*, 119 So. 2d 432, 437 (Fla. 1st D.C.A. 1960). So, a surety in a payment bond for a building contractor could not claim the benefit of the contractor or his creditor's rights until it had met or settled the claims of creditors against the contractor: *In re Eastern Marine, Inc.*, 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989). The United States Bankruptcy Code, 11 U.S.C. § 509 (c), subordinates the surety or co-debtor's claim for subrogation to the claim of the creditor: "The court shall subordinate to the claim of a creditor and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement or contribution of an entity that is liable with the debtor on, or that has secured, such creditor's claim, until such creditor's claim is paid in full..." Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1348-9, takes the view that the creditor and surety could not have intended that the surety should be allowed to claim subrogation so as to impair the creditor's rights against the principal.

[74] One may note the early Exchequer case *Anon.* (1582) Savile 30, pl. 72, where a surety for a collector of taxes was not allowed to take the benefit of Crown process to recover from the principal debtor where there might have been sums remaining "on account" for the creditor. One must also note a contrary statement by Lord Templeman, speaking on behalf of the Privy Council in *China and South Sea Bank Ltd.* v. *Tan* [1990] 1 A.C. 536, 545, which, however, is clearly *obiter*.

[75] Or a lesser sum in satisfaction of the larger. See *Ex parte Rushforth* (1805) 10 Ves. 409, 420 *per* Lord Eldon ("The rule certainly has been, that, where a man, engaged for the whole of a debt, pays only a part, he has no equity to stand in the place of the person paid"); *Ewart* v. *Latta* (1865) 4 Macq. H.L.C. (Sc.) 983. Also, *Gedye* v. *Matson* (1858) 25 Beav. 310, 312. See also *In re Sass* [1896] 2 Q.B. 12; *Ellis* v. *Emmanuel* (1876) 1 Ex. D. 157; *Huggard* v. *Representative Church Body* [1916] 1 I.R. 1; *In re 19th Ltd.* [1989] I.L.R.M. 652.

for an amount less than the full debt owing from the debtor. The modern rules are expressed in *In re Sass*[76] by Vaughan Williams J. as follows:

> "The surety has a right, having paid part of the debt ... to stand in the shoes of the principal creditor ... In my judgment that right of the surety as against the principal creditor only arises in a case where the surety has paid the whole of the debt. It is quite true that where the surety is surety for a part of the debt as between the principal creditor and the debtor, the right of the surety arises merely by payment of the part because that part, as between him and the principal creditor, is the whole."[77]

In *Huggard* v. *Representative Church Body*,[78] O'Connor M.R. adopted a passage from Halsbury,[79] to the effect that where a guarantee is a continuing one for a floating balance which may from time to time be due from the debtor to the creditor, it will *prima facie* be construed as one applicable only to a part of the debt co-extensive with the amount of the guarantee. Therefore, on payment of that amount, the surety will be held entitled to subrogation, unless he has waived his right. On the other hand, a guarantee of an ascertained debt, limited in amount, will not *prima facie* be so construed, the question remaining one for the court.[80]

Examples of the first category may be given. In *Ex parte Wood*,[81] Lord Thurlow held that a surety by bond for advances generally, but under a limited penalty, was not liable beyond that penalty; upon paying that amount, he was entitled to a proportion of the dividends from a proof by the creditors to a greater amount under the principal debtor's insolvency. In *Thornton* v. *McKewan*,[82] a surety had given a creditor a continuing guarantee of the principal's indebtedness, to the extent of £5000, against losses the creditor might suffer as a result of advances to be made to the principal debtor. At the time of execution of the guarantee, the principal was already indebted to the creditor in a far larger amount. After the principal debtor's death, the creditor received dividends from his estate. He later recovered the £5000 in an action against the surety. The surety then filed a bill claiming a share of the past and future dividends in so far as they were received in respect of the £5000. The court made such a decree. It was held that the surety had

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[76] [1896] 2 Q.B. 12.
[77] [1896] 2 Q.B. 12, 14. There is a similar passage in the judgment of Lord President Inglis in *Harvie's Trustees* v. *Bank of Scotland* (1885) 12 R. 1141, 1145.
[78] [1916] 1 I.R. 1.
[79] 1st ed., XV, 475 (by H.A. de Colyar). See also H.A. de Colyar, *A Treatise on the Law of Guarantee and of Principal and Surety* (3rd ed., 1897), 236.
[80] This was based on the decision of the Court of Appeal in *Ellis* v. *Emmanuel* (1876) 1 Ex. D. 157.
[81] (1791, Lord Thurlow L.C.), referred to by Lord Eldon in *Ex parte Rushforth* (1805) 10 Ves. 409, 415; cited in Chitty's Digest, VII, 6658. In *Rushforth*, Lord Eldon expressed polite disapproval of the earlier case.
[82] (1862) 1 Hem. & M. 525; 1 N.R. 16; 11 W.R. 140; 32 L.J. Ch. 69.

not lost his equitable right by failing to plead a set-off to the action by the creditor.[83] In *Hobson* v. *Bass*,[84] the surety signed a guarantee for the price of all goods supplied by the creditor to the principal, but so as his liability to the creditor should not exceed £250. This was held to be a guarantee of £250 only, and on payment of this amount, the surety was entitled to a share in the dividend payable by the principal in respect of his debts to the creditor. The guarantee in *In re Sass*[85] was extremely similar, though Vaughan Williams J. there came to the opposite conclusion. One tends to think that the conclusion in the later case was more in accordance with the natural meaning of the words. In *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.*,[86] Oliver L.J. stated that a guarantee of a fluctuating balance, with a limitation on liability, would ordinarily be interpreted as a guarantee of part only of the debt. However, a provision that the guarantee was in addition to and without prejudice to other securities was normally sufficient to imply that the guarantee was for the whole of the debt, with a limitation merely on liability. However, Oliver L.J. also stated that there had to be some express term in the contract which could fairly be interpreted as a waiver by the surety of his rights against the principal.

In re Butler's Wharf Ltd.,[87] the guarantee signed by the surety did not state that it was to be for the entire of the debt. Instead, it was clearly for a smaller amount. However, the document provided that it was a "continuing security," and that it was in addition to and should not affect or be merged in any other securities which the creditor held. The surety had paid the sum for which he was liable, and now claimed a share in the proceeds realised from securities granted to the creditor by the principal debtor.[88] Counsel for the creditor argued that if, because of the guarantee, the creditor was prevented from applying proceeds of other securities to the payment of other parts of the principal debt, this would "affect" the creditor's other securities. Reliance was also placed on the judgment of Oliver L.J. in *Barclays* v. *T.O.S.G.* Mr. Sykes Q.C., sitting as a deputy High Court judge, observed that there was no term which could be interpreted as a waiver of the surety's right of subrogation here, and therefore held that the surety was entitled to a share of the proceeds of the security. In any event, the guarantee and the surety's rights arising out of it, did not "affect" the creditor's other security.

Examples of the other category, where a surety guarantees the payment of the entire amount of the principal's debt, but with a limitation on liability include the following cases. In *Ulster Bank* v. *Lambe*,[89] two sureties had paid the amount of the limitation on their liability. The guarantees which they had signed provided that the bank should be entitled to prove and receive dividends from the estate of the

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[83] See also *Hobson* v. *Bass* (1871) L.R. 6 Ch. 792; *Gray* v. *Seckham* (1872) L.R. 7 Ch. 680; *Paley* v. *Field* (1806) 12 Ves. 435; *Goodwin* v. *Gray* (1874) 22 W.R. 312.
[84] (1871) L.R. 6 Ch. 792.
[85] [1896] 2 Q.B. 12.
[86] [1984] A.C. 626, 644.
[87] [1995] B.C.C. 717.
[88] See also *Goodwin* v. *Gray* (1874) 22 W.R. 312.
[89] [1966] N.I. 161.

principal for the full debt, notwithstanding any payments made by the surety. It was held that the creditor remained entitled to prove against the principal's estate for the full amount of the debt, until such time as he was paid in full. Any surplus amount which he received beyond the amount which was necessary to repay him in full would be subject to a trust in favour of the sureties.

The same judge reiterated his views five years later.[90] He added the gloss that if the surety paid a lesser sum to the creditor in discharge of the entire debt, then he would nonetheless be entitled to claim against the principal, as the creditor's claim would have been discharged.[91] In *Huggard* v. *Representative Church Body*,[92] it was held that a purchaser of a portion of a mortgaged estate, who had covenanted to pay the mortgage debt and had paid a portion of it, was not entitled to share in the proceeds of sale of the remainder of the mortgaged estate, even assuming that he had the character of a surety, as he had covenanted to pay the entire debt, with merely a limitation on liability.

In *In re 19th Ltd.*,[93] a company had executed a mortgage of certain property it held as security for a loan to a connected company. There was no covenant to pay, nor was there any document containing the terms of the guarantee between the mortgagor company and the creditor. The mortgage was said to secure all moneys due or to become due from the principal to the creditor. Lynch J. held that this indicated that it was a guarantee of the entire debt. He was fortified in this conclusion by the fact that if the guarantee was a limited one, the amount of the "limit" could not be ascertained until the mortgaged property had been sold, and the price realised. Thus, if the guarantee had been a limited one, the limit might have varied greatly depending on the time of realisation.[94]

Also, it seems that an accommodation indorser of a bill of exchange, who is treated in virtually every respect as a surety, will not be allowed to claim against the drawer (the principal debtor) until the holder has been paid in full. This emerges from the case of *Ex parte Marshal*,[95] in which holders of bills of exchange had proved in the bankruptcies of the drawer (principal debtor) and accommodation acceptor (surety). They obtained a dividend in each bankruptcy, but not enough in total to equal the amount of the bills. The assignees in bankruptcy of the acceptor now claimed to be entitled to stand in the place of the holders and prove in the drawer's estate for the amount which the acceptor had been forced to pay the

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[90] *In re An Arranging Debtor No. A. 1076* [1971] N.I. 96, 105.
[91] Although the judge did not say so in terms, the surety's recovery will be limited to the amount which he pays to the creditor, plus interest, if any, and costs. This is because the surety's claim can only be for indemnification. However, the surety would, it seems, be entitled to prove in the bankruptcy of the principal for the entire amount of the debt, as he would be subrogated to the claim of the creditor. He would only be limited in his eventual *recovery*.
[92] [1916] 1 I.R. 1.
[93] [1989] I.L.R.M. 652.
[94] See also *Forster Dry Cleaning Co.* v. *Davidson* (1963) 187 E.G. 519.

holders. Lord Hardwicke L.C. made such an order, but also provided that the acceptor's assignees should only be entitled to prove against the drawer's estate after the holders had been paid in full.[96]

Although it does not seem entirely logical, there is some authority in support of the proposition that a surety who has admittedly paid only a part of the amount for which he is bound, may nonetheless claim against his principal debtor in competition with the creditor, by personal action for money paid, or its equitable equivalent. This depends to some extent on whether or not a part payment is regarded as *pro tanto* a discharge of the principal's liability to the creditor.[97] Standard form contracts of guarantee routinely exclude any such right prior to the complete satisfaction of the creditor.[98]

2.3.d Application of the rule in cases of Insurance

It does seem comfortably established that an insurer will only be permitted to exercise rights of subrogation once he has paid to the insured all sums due under the contract of insurance. So, in *Page* v. *Scottish Insurance Corporation*,[99] it was held that an insurer obtained no right of subrogation in respect of

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[95] (1752) 1 Atk. 129. *Cf.* the case of *Ex parte Walton* (1743) 1 Atk. 122, discussed in *Ex parte Marshal* (1752) 1 Atk. 129, 130, where it seems that an acceptor's assignees were allowed to prove *pro tanto* against the drawer's estate, for what the acceptor's estate had paid to the holders.

[96] This is an interesting decision, as it seems to preclude the result in the Scottish case of *The Royal Bank of Scotland* v. *Commercial Bank of Scotland* (1882) 7 App. Cas. 366, in which it was in effect held that if the acceptor's estate pays a dividend, it is then entitled to prove against the drawer's estate, thereby producing more assets for the acceptor's estate. These assets then become liable to be distributed among the creditors of the estate of the acceptor, who thus obtain another dividend. This process can then be continued until no further assets remain in the estate of the drawer. See Williams, "A Creditor's Right to his Surety's Securities," (1888) 1 Harv. L. Rev. 326.

[97] In *In re An Arranging Debtor No. A. 1076* [1971] N.I. 96, 106, it was said that a part payment was not *pro tanto* a discharge. However, to the contrary, see Mitchell, *op. cit.*, 55 note 20; Harris, *op. cit.*, § 29; *Davies* v. *Humphreys* (1840) 6 M. & W. 153, 167 *per* Parke B. In *Sleigh* v. *Sleigh* (1850) 5 Ex. 514, 515, Parke B. said that the payment of part of the principal's debt was *pro tanto* a discharge of the principal's liability. However, the surety in that case had paid when he was not bound to do so, and therefore could not recover his payment from the principal. In *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.* [1984] A.C. 626, affirming [1984] B.C.L.C. 27, reversing [1984] B.C.L.C. 1, A. had agreed with B. that in the event of default by C. in its obligations to D., A. would pay a certain sum to B., which B. would apply to pay D., and repay any balance to A. C. granted A. an indemnity against this liability. On C.'s failure, A. paid B., who paid D. D.'s claim was not satisfied in full. The House of Lords held that, upon A.'s payment to B., A. became entitled to sue C. on the indemnity. Furthermore, when B. paid D., D.'s claim against A. was extinguished *pro tanto*. However, in this case, B. was not a surety for C. to D. in the strict sense. See also Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1346 (considering suretyship); *United States Fidelity & Guaranty Co.* v. *Centropolis Bank of Kansas City, Missouri*, 17 F. 2d 913, 917-8; 53 A.L.R. 295 (8th Cir. 1927) (surety had paid amount for which it was liable, though creditor had not been paid in full; though surety admittedly not entitled to subrogation, nonetheless held entitled to prove in competition with the creditor) and *Cleary Brothers Construction Co.* v. *Upper Keys Marine Construction, Inc.*, 526 So. 2d 116, 117 (Fla. 3rd D.C.A. 1988).

[98] Or sometimes provide that any moneys received by the surety under such claim or proof should be held on trust for the creditor.

[99] (1929) 33 Ll. L. Rep. 134.

a first party claim which it had paid until it had paid a third party claim in respect of which it was also liable. Some difficulty arises if the insurer pays the full amount which it is obliged to under the policy, but the insured has suffered a further, uninsured, loss. It seems that it is necessary to distinguish a number of different situations:

(i) Non-Marine Indemnity Insurance

In cases of such insurance, it seems that the insurer is not entitled to be subrogated until the insured has been fully indemnified, *i.e.* he has recovered the entire of his loss from insurer and third party.[100] Indeed, Horn has suggested that one of the reasons why subrogation is generally denied in cases of life insurance is that one cannot say at what point the insured, or the beneficiary, has been fully indemnified, a human life or human welfare being incapable of measurement in pecuniary terms.[101] Clearly, in so far as subrogation is regarded as designed to prevent an insured making a profit from the injury suffered, there is no reason to call it into play, as, *ex hypothesi*, the insured has not yet been made whole.[102]

The general rule is illustrated by *In re Driscoll; Driscoll* v. *Driscoll*.[103] In that case, a lessee who had covenanted to keep the premises in repair had insured the demised premises, and sub-demised it. The sub-lessee also covenanted to keep the premises in repair. A fire occurred, and his insurer paid the lessee. The proceeds were, however, not enough to reinstate the premises. The lessee remained liable to the lessor, and would have to meet the deficit by claiming from the sub-lessee, or by reaching into his own pocket. The insurer claimed to have been subrogated to the lessee's rights against the sub-lessee for breach of the latter's covenant to keep in repair. The Court of Appeal dismissed the claim, O'Connor M.R. saying as follows:

> "A contract of insurance against fire is only a contract of indemnity, and I think that the foundation of the doctrine of subrogation is to be found in the principle that no man shall be paid

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[100] Most American courts seem to accept that this is the case at common law: *Rimes* v. *State Farm Mutual Automobile Insurance Co.*, 106 Wis. 2d 263; 316 N.W. 2d 348, 353 (1982); *Higginbotham* v. *Arkansas Blue Cross and Blue Shield*, 312 Ark. 199; 849 S.W. 2d 464, 466 (1996); Greenblatt, *op. cit.*, 1341.
[101] R.C. Horn, *Subrogation in Insurance Theory and Practice* (Ph.D. thesis, University of Pennsylvania, 1962), 34: "in equity, subrogation could not be accorded until the loss had been fully paid; accordingly, the courts reasoned that only indemnity contracts could meet this complete payment stipulation, for the subject matter of such insurance was generally amenable to financial mensuration of value."
[102] *Rimes* v. *State Farm Mutual Automobile Insurance Co.*, 106 Wis. 2d 263; 316 N.W. 2d 348, 353 (1982).
[103] [1918] 1 I.R. 152.

twice over in compensation for the same loss. The corollary to this is that a contract of indemnity against loss should not have the effect of preventing the insured from being paid once in full."[104]

In *Confederation Life Insurance Co.* v. *Causton*,[105] it was held that disability benefit policies which were related to income loss were contracts of indemnity. The insured recovered a sum in respect of loss of income from a third party. However, one quarter of this went to pay his lawyer's contingency fee. The court held that the insurer could only be subrogated to the benefit of the award of damages once the insured had received full compensation for his loss. This had not happened here, as the insured's loss involved the cost involved in obtaining recovery from the third party, including legal expenses incurred during the process.[106] In *Shelter Insurance Co.* v. *Frohlich*,[107] it was stated that in the absence of a valid contractual provision to the contrary, an insurer under the medical payments provision of a motor insurance policy could exercise its rights only when the insured had been fully compensated for his loss.[108] This, indeed, appears to be the doctrine applied in the vast majority of American jurisdictions.[109] Statute expressly provides for this result in some states.[110]

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[104] See also *Globe & Rutgers Fire Insurance Co.* v. *Truedell* [1927] 2 D.L.R. 659. In *Doyle* v. *Wicklow County Council* [1974] I.R. 55, 72, Griffin J. stated that "the insured person ... must ... repay to [the insurer] anything which he receives beyond a complete indemnity." This at least suggested that the insurer was not entitled to anything until the insured had been fully indemnified.

[105] (1989) 60 D.L.R. (4th) 372 (S.C., B.C.).

[106] Some American courts have also held that the insured is entitled to be reimbursed the amount of its unrecovered legal expenses before the insurer is permitted a share in sums recovered by the insured: *Powers* v. *Calvert Fire Insurance Co.*, 216 S.C. 309; 57 S.E. 2d 638 (1950). See also *Mutual Life Assurance Co.* v. *Tucker* (1993) 119 N.S.R. (2d) 417; 314 A.P.R. 417; noted [1994] Rest. L. Rev. § 98, where it was said that equity would not operate piecemeal, so as to transfer the insured's claim against a third party to an insurer *pro tanto*. *Cf.* a recent Canadian case where it was held that an unallocated sum recovered by the insured from the third party in a settlement should be apportioned between insurer and insured in the proportion that the insured loss bore to the total loss: *Affiliated F.M. Insurance Co.* v. *Quintette Coal Ltd.* (1998) 156 D.L.R. (4th) 307 (B.C. C.A.). On this issue, see further, *post*. This is a "*pro rata*" approach. It is possible that an issue of the *bona fides* of a settlement may arise. Greenblatt, *op. cit.*, 1353, is critical of the application of the stated rule in the context of settlements.

[107] 243 Neb. 111; 498 N.W. 2d 74 (1993).

[108] See also *Eastwood* v. *Glens Fall Insurance Co.*, 646 S.W. 2d 156 (Tenn. 1983), where an insurer was denied any entitlement to the proceeds of a settlement with a tortfeasor which, when added to the sum the insurer had paid the insured, still did not fully compensate the insured for his loss.

[109] See, *e.g.*, *White* v. *Nationwide Mutual Insurance Co.*, 361 F. 2d 785, 787 (4th Cir. 1966); *Travelers Insurance Company* v. *Commercial Union Insurance Company*, 335 S.E. 2d 681 (Ga. App. 1985); *Cherokee Insurance Company* v. *Lewis*, 371 S.E. 2d 103, 105 (Ga. App. 1988).

[110] In Georgia, a no-fault insurance statute (O.C.G.A. § 33-34-3(d)(1)) provided a no-fault accident insurer with a right of subrogation. However, where the third party tortfeasor was uninsured, the statute provided that "the insurer ... shall have a right of action to the extent of benefits provided against such tort-feasor only in the event that the person for whom benefits are provided has been completely compensated for all economic and noneconomic losses incurred as a result of the motor vehicle accident": see *Travelers Insurance Company* v. *Commercial Union Insurance Company*, 335 S.E. 2d 681 (Ga. App. 1985). Another statutory provision provided a right of subrogation in relation to uninsured motorist coverage: O.C.G.A. § 33-7-1(f). However, it did not address the issue of whether the insured first had to be made whole. In *Cherokee Insurance Company* v. *Lewis*, 371 S.E. 2d 103 (Ga. App. 1988), the court held that the insurer's right did not arise until the insured had been completely satisfied. See also *Mullenberg* v. *K.J. Saxon Construction Company*, 384 S.E. 2d 419 (Ga. App. 1989).

(ii) Marine Insurance

Under Section 81 of the Marine Insurance Act 1906, if the insured has insured for less than the insurable value, then he is deemed to be his own insurer for the difference. In such a case, recoveries by the insured against a third party will be divided *pro rata* between the insured and insurer.[111]

(iii) "Value" Policies

Where the insured property had an agreed value, if the insurer pays this amount, he will be entitled to all recoveries from a third party until he has recovered the amount which he has paid to the insured. The insured is estopped from denying that he received a full indemnity.[112]

(iv) "Average" Clauses

An "average" clause is one which provides that, if other insurance policies exist which cover the same subject-matter, then the insurer shall not be liable to pay more than his rateable proportion of the value of the insured subject-matter. In a case of under-insurance, the effect is the same as in cases of marine insurance: the insured is deemed to have been his own insurer for the deficit, and recoveries from third parties will be divided proportionately between the insurer and insured.

(v) Other Contractual Provision

Aside from the cases of "value" policies and "average" clauses, the insured may contract to bear a certain portion of the loss. Such a case is treated as a case of multiple insurers, each bearing a different portion of the loss. This has been called the "top down" method. Thus, in *Napier* v. *Hunter*,[113] the insured had agreed to bear (a) an excess and (b) all loss above a certain sum. The example used in the case was of an insured who bears the first £25,000 of loss, and all loss beyond £125,000. The insurer agreed to bear the amount of loss above £25,000, up to a limit of £125,000. If a loss of £160,000 was suffered, the insurer then paid the insured what he was obliged to pay, and the insured then recovered £130,000 from a third party, it was held that that sum should be distributed as follows:

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[111] *The Commonwealth* [1907] P. 216.
[112] *Goole and Hull Steam Towing Co. Ltd.* v. *Ocean Marine Insurance Co. Ltd.* [1928] 1 K.B. 589. On one view, a value policy is not an indemnity policy: Horn, *op. cit.*, 42-3.
[113] [1993] 2 W.L.R. 42.

(a) the loss beyond the limit of £100,000 (*i.e.* from £125,000 upwards) had been agreed to be borne by the insured. Thus, he was entitled to the first £35,000 of the amount recovered. This represented the amount of the loss between £125,000 and £160,000.

(b) the insurer should be entitled to the next portion of the recovery, up to the ceiling of £100,000. This represents the loss which the insurer bore under the contract. In the example used, only £95,000 is available to meet this loss.

(c) if any further sum had been available, it would have gone to the insured, who had borne the first £25,000 of the loss.[114]

This supposed "top-down" principle was applied by Rix J. in *Kuwait Airways Corporation* v. *Kuwait Insurance Co. S.A.K.*,[115] where the judge held that the amount of sums received should first go to reimburse the insured for its losses beyond the limit of the insurer's liability. After the insured had been reimbursed that amount, the insurer would be entitled to any balance. Rix J. seemed to regard the decision in *Napier* v. *Hunter* as establishing a general "top-down" principle. He noted that the position might be different in cases of marine insurance. However, he guardedly expressed the opinion that the insured was entitled to the benefit of this supposed principle because it "most closely conform[ed] to the underlying rationale of subrogation."[116] It seems unlikely that there is any general "top-down" principle outside the contractual framework of *Napier* v. *Hunter*. Otherwise, the general rule that the insured should first be fully indemnified should apply.

American courts have with some frequency considered policies which expressly provided that, upon payment of the insured amount by the insurer, it was *ipso facto* subrogated to the insured's rights, and even took priority over the insured in respect of any sums forthcoming from third parties. These clauses have not always been enforced by the courts. Greenblatt[117] argues that, while the general rule discussed here is proper in cases of suretyship, there is no good reason for it in cases of insurance, as (he assumes) the insurer will not be competing with the insured for a share of a security or the proceeds of a

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[114] Mitchell, "Subrogation and insurance law: proprietary claims and excess clauses," [1993] L.M.C.L.Q. 192, 203 queries why the insured was allowed first to recover the amount beyond the limit, but was not allowed to recover the excess until last. He speculated that the reason might have been that the effect of the excess clause was to curtail the scope of the coverage. Therefore, it was directly in issue when considering the principle of indemnity. On the other hand, the effect of the limitation clause was to limit the quantum of the amount payable once the specified losses had arisen. It seems easier merely to state that the system adopted by the House of Lords reflected the presumed intent of the parties.

[115] [1996] 1 Lloyd's Rep. 664.

[116] [1996] 1 Lloyd's Rep. 664, 695. Appeals to the Court of Appeal, [1997] 2 Lloyd's Rep. 687 and the House of Lords, [1999] 1 Lloyd's Rep. 803, did not concern this point.

[117] *Op. cit.*, 1351.

security.[118] He also observes that it matters not to insurers which method of division is employed, as long as they can anticipate its application in setting premiums.[119] He concludes that a rule under which the insurer is subrogated *pro tanto* for its payment to the insured is more economically efficient. It permits the purchase of cheaper insurance, thereby benefitting the risk adverse, on the assumption that it is cheaper to recover the first pound of the loss than the last. This is aside from issues of moral hazard and "litigation incentives": that the subrogation claim will be run more effectively if the insured has a strong financial incentive to co-operate.[120]

2.3.e Application of the rule in cases of Payers of the Debt of Another and Lenders

It seems that no rule similar to that of the supposed maxim applies in English or Commonwealth law to cases where one lends money to a borrower for the purposes of discharging an incumbrance, or directly makes a part payment to the incumbrancer.[121] Thus, in *Chetwynd* v. *Allen*,[122] Romer J. held that a lender had been subrogated to the benefit of a mortgage over property owned by the borrower's wife to the extent to which the funds had been applied in payment of that mortgage. However, the mortgagee's outstanding claim for the balance of the mortgage debt would have priority over the claim of the subrogated lender.[123]

A New Zealand decision seems to accord with this conclusion, though the case can perhaps be understood as turning on an agreement between debtor and payer. In *Tanner Fitzgerald Nominees Ltd.* v. *Johnson Farm Management Pty. Ltd.*,[124] a third party advanced the amount of outstanding interest to a first mortgagee, in order to forestall a sale of the mortgaged premises. The payer hoped to be able to organise a "re-financing" of the debts. The payer had advanced the money on terms that it was to become a contributory to the first mortgagee's mortgage. It was held that the payer was entitled to be subrogated to the first mortgagee's rights to the extent of its payment. Although the court seems to have justified this conclusion as reversing an unjust enrichment of the debtor, the decision seems equally explicable on the ground that the payer and mortgagee had agreed that the payer should share the rights of the mortgagee.

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[118] This will normally be true, but there are instances where an insured may have a secured or proprietary right against a third party, *e.g.*, under mortgagee's insurance. However, Greenblatt mistakenly thinks that the insurer is free to pursue his own personal right to reimbursement from the third party: *op. cit.*, at 1350-1.

[119] *Op. cit.*, 1355-6.

[120] *Op. cit.*, 1357-9.

[121] An Indian authority, however, supports the application of the rule under consideration: *Hanumanthaiyan* v. *Meenatchi Naidu* (1911) I.L.R. 35 Madras 183, 185: "Otherwise the result would be that a number of persons would be entitled to rank as first incumbrancers with reference to different sums of money advanced by them, and it would be impossible to work out the rights of the parties."

[122] [1899] 1 Ch. 353.

[123] [1899] 1 Ch. 353, 357. The decision was approved, on this point as well as others by Lord Hoffmann, with whom a majority of the members of the House of Lords agreed, in *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 748.

Furthermore, the recent decision of the House of Lords in *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*[125] is consistent with these earlier decisions. In that case, the Court of Appeal had held that there was a conceptual problem with the subrogation of the lender to part of the debt secured by a charge in favour of a certain creditor, as the creditor would be prejudiced by the subrogation. Lord Hoffmann, with whom a majority of members of the House agreed, stated that he did not feel that there was any conceptual difficulty, as the incumbrancer would retain priority over the subrogated lender for the balance of his claim.[126] He said:

> "In a case like the present, in which part of the secured debt is repaid, the charge remains alive only to secure the remainder of the debt for the benefit of the original chargee. Nothing can affect his rights and there is no question of competition between him and the party claiming subrogation."[127]

This conclusion also followed from another aspect of the case, which is not immediately material here.[128] Lord Hutton came to a similar conclusion.[129]

2.3.f Application of the rule to Payers who have an Interest in Land

Although no argument seems to have been raised on this exact point, the case of *Pitt* v. *Pitt*[130] suggests that the supposed rule does not apply in cases where a part owner of land makes payments towards the discharge of an incumbrance on the land. In that case, a husband had paid in part a mortgage granted by his wife on property which had at the time of grant been vested in her, but which had come to be vested in him subject to a right of survivorship on the part of the wife. It was held that his estate should have the benefit of the sums paid by him out of his own estate, "and that the redemption [by the wife] ought to be upon the terms, that the family be permitted to stand in the place of the mortgagee, for the amount in which the husband has reduced the debt."[131] The decision in *Pitt* v. *Pitt*[132] has recently been approved in Northern Ireland, Girvan J. stating that "[h]e who discharges another's secured obligation, wholly or in part, is entitled to be repaid out of the security the amount of the sum or sums paid by

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[124] [1994] Rest. L. Rev. § 219 (note).
[125] [1998] 1 All E.R. 737.
[126] [1998] 1 All E.R. 737, 748.
[127] [1998] 1 All E.R. 737, 749.
[128] Namely that the lender was only subrogated to the security *vis-à-vis* another party, the second chargee. For further discussion of the case, see sections 3.10, 6.2.a, and 6.2.d, *post*.
[129] [1998] 1 All E.R. 737, 755-6.
[130] (1823) Turn. & R. 180.
[131] At 184. See further on this case section 11.2, *post*.
[132] (1823) Turn. & R. 180.

him."[133] Since the payment in that case was of the entire of the secured debt, the reference to a part payment is *obiter*.

The only other approximate Irish authority in point is a case where the court considered section 33(4) of the Land Law (Ireland) Act 1896.[134] That section provided that where a rent was payable in respect of lands sold under the Land Purchase Acts, but the lands sold had a right of indemnity from another estate, a person who paid the rent became entitled to a rent on the indemnifying estate equal in amount to the portion of the rent which he had redeemed. In *De Vesci* v. *O'Connell*,[135] it was held that the rent so created or deemed to have been purchased by the payer ranked in priority *after* the unredeemed portion of the rent.

2.3.g Application In Case of Payment by Minister under Protection of Employees (Employers' Insolvency) Act 1984

Under Section 10 of the Protection of Employees (Employers' Insolvency) Act 1984, when the Minister for Enterprise and Employment makes a payment to an employee under the Act, "any rights and remedies of the employee in respect of that debt ..... shall, on the making of the payment, become rights and remedies of the Minister". These include, in particular, the employees' preferential rights on the insolvency of the employer. Subsection (2) states that

> "the Minister shall be entitled to be paid in priority to any other unsatisfied claim of the employee concerned being a claim which, but for this subsection, would be payable to the employee in such priority."

Therefore, the section expressly excludes any operation of the maxim: the subrogated party must take precedence over the creditor (the employee).

2.4 Which payments are effective to discharge a Debt

Where two or more parties are bound for the payment of the same debt, whether jointly, jointly and severally, or severally, payment of the entire sum due or payment of a part of the entire sum due in

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[133] *Stronge* v. *Johnston*, unreported, Northern Ireland, High Court, Chancery Division, Girvan J., 16th April 1997, 1996 No. 1534, quoting from *Cowcher* v. *Cowcher* [1972] 1 W.L.R. 425, 432 (*per* Bagnall J.). The case is discussed by Capper, "The Debtor, the Wife, the Farm and the Opportunist," (1997) 48 N.I.L.Q. 400.

[134] 59 & 60 Vict., c. 47.

[135] [1908] 1 I.R. 452 (H.L.), reversing *In re Thomson's Estate* [1907] 1 I.R. 311, reversing [1907] 1 I.R. 191.

satisfaction of the entire, will be effective to discharge the debt.[136] The creditor will therefore no longer be entitled to recover again against any of the other parties liable. If one pays another's debt at the request of that party, if the creditor accepts payment, that will be effective to discharge the debt of the other party.

As regards payments by voluntary interveners, the law in England and Ireland appears to be that his payment does not in itself have the effect of discharging the liability of the debtor.[137] However, if the payment is made on the debtor's account, and is adopted by the debtor, which can be done by raising it as a defence to an action by the creditor, then it becomes an effective discharge.[138] The effect of a mistaken payment may be a matter of some complexity, and is considered in sections 4.3.a and 6.2.

Payment by an insurer does not generally cause the discharge of third parties who are liable to the insured in respect of the same injury. The reasons usually advanced to explain the subsistence of the liability of the third party to the insured tend to be (i) that the payment by the insurer to the insured was made on the foot of a contract between those two, for which the insured had paid consideration, to which the third party was not a party, and the benefit of which should not enure to relieve him of liability;[139] (ii) that the continued liability of the third party serves to uphold the punitive or deterrent objects of tort liability, or the like effects imposed as a consequence of the breach of contract. The first of these two reasons is sometimes expressed as the theory that "collateral sources" of recovery to a plaintiff are not

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[136] Mitchell, *op. cit.*, 7; Dixon, *op. cit.*, 156-7. Mitchell offers two explanations. First, where the surety became such by agreement with the principal, his payment is *ipso facto* deemed to have been authorised by the principal, and therefore, as discharging the debt: *op. cit.*, 52. See *Sleigh* v. *Sleigh* (1850) 5 Ex. 514, 517 *per* Parke B. ("such payment is, in truth, under the implied authority given by the contract of accommodation between the parties"). Secondly, both the principal and surety were liable to a common demand, and where the surety is compelled to make payment to the creditor, he is entitled to recover it from the principal, who is, as between the two of them, the one primarily liable; *op. cit.*, 52-3; Goff and Jones, *op. cit.*, 449-50 (if two are liable jointly and severally, payment by one discharges the other). Compare *Gardner* v. *Brooke* [1897] 2 I.R. 6, 12 *per* O'Brien J.

[137] *Walter* v. *James* (1871) L.R. 6 Ex. 124. Numerous cases are listed by Goff and Jones, *op. cit.*, 17, note 2.

[138] *Belshaw* v. *Bush* (1851) 11 C.B. 191; *Kemp* v. *Balls* (1854) 10 Ex. 607; *Simpson* v. *Eggington* (1855) 10 Ex. 845; *Purcell* v. *Henderson* (1885) 18 L.R. Ir. 466, affirming (1885) 18 L.R. Ir. 213 (payment of arrears of rent by a third party with the motive of obtaining a lease for himself could be raised as a defence by the lessee in an action for rent by the lessor). See Goff and Jones, *loc. cit.*

[139] See, *e.g.*, *Bradburn* v. *Great Western Railway Co.* (1874) L.R. 10 Exch. 1; *British Westinghouse Electric and Manufacturing Co. Ltd.* v. *Underground Railways Company of London Ltd.* [1912] A.C. 673, 690 *per* Viscount Haldane L.C.; *Parry* v. *Cleaver* [1970] A.C. 1, 14 *per* Lord Reid; *Stafford Metal Works, Inc.* v. *Cook Paint and Varnish Co.*, 418 F. Supp. 56, 58 (N.D. Tex. 1976); *Preferred Risk Mutual Insurance Co.* v. *Courtney*, 393 So. 2d 1328 (Miss. 1981); *Becton Dickenson U.K. Ltd.* v. *Zwebner* [1989] 1 Q.B. 208, 213; *Europe Estate Company* v. *Halifax Estate Agencies*, *The Times*, 23rd May, 1996, noted by Quinn-Smith [1996] L.M.C.L.Q. 446; Mitchell, "English Insurance Decisions 1996," [1997] L.M.C.L.Q. 295, 303; J. Mestre, *La Subrogation Personnelle* (1979), § 239; Kimball and Davis, "The Extension of Insurance Subrogation," (1962) 60 Mich. L. Rev. 841. Derham, *op. cit.*, 29-30, is critical, stating that this argument is "...is premised on the assumption that the third party would have been the subject of an action by the person suffering the loss even if that person had not had insurance coverage." However, this would often not be the case.

deductible from the plaintiff's award of damages against a defendant who is liable for the loss suffered.[140] The second of these grounds can be supported by reference to enterprise risk theories, to the effect that one who controls a source of danger should be encouraged to minimise the dangers to third parties by the risk of liability to such parties.[141] A further, related justification, is the desire to minimise the "moral hazard" - the risk of collusive and fraudulent claims, if the third party could effectively pass his liability on to the insurer, at no cost to himself.[142] It should be noted that, if it is accepted that the third party remains liable to the insured after payment by the insurer, the insured may then proceed to recover from the third party, and obtain a double recovery. The moral hazard is in such a case averted by holding the insurer to have been subrogated to the insured's rights against the third party.[143]

Whatever weight one chooses to give to each of these factors, there are some circumstances where the insurer's payment is regarded as, in effect, discharging the liability of the third party to the insured. In such cases, the courts have expressed a view that the liability of the insurer is in effect primary, and that he should not therefore have the benefit of subrogation.[144] The "collateral source" rule is therefore held not to apply.[145]

2.5 The Significance of the Discharge of the Debt

It is commonly said in the United States that subrogation assumes the discharge of the debt, while assignment assumes its continued existence.[146] The effect of subrogation is said to be that a debt which would otherwise be regarded as having been discharged, is "revived," or treated as still subsisting for the benefit of the payer.[147] However, most American jurisdictions also acknowledge that payment by

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[140] *Thompson* v. *Milam*, 115 Ga. App. 396; 154 S.E. 2d 721 (1967); *Mullenberg* v. *K.J. Saxon Construction Company*, 384 S.E. 2d 419, 420 (Ga. App. 1989).

[141] *Cf.* Rudden, "Soviet Tort Law," (1967) 42 N.Y.U. L. Rev. 583, 625, citing various Soviet writers.

[142] Quinn, "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1372.

[143] Or, in a case where the insured has already recovered from the third party, granting the insurer a right to recover all or part of this amount from the insured. See section 10.5, *post.*

[144] *Mark Rowlands Ltd.* v. *Berni Inns Ltd.* [1986] 1 Q.B. 211, 233 *per* Kerr L.J.

[145] See the argument of counsel in *Mark Rowlands Ltd.* v. *Berni Inns Ltd.* [1986] 1 Q.B. 211, at 217-8. For full discussion, see sections 10.3.a and 10.3.b, *post.*

[146] See, *e.g.*, *Gilbert* v. *Dunn*, 218 Ga. 531; 128 S.E. 2d 739, 741 (1962): "The heart of the question ... is whether or not the subrogee discharged the debt, and the manner in which this was accomplished is immaterial." See also *In re Towey, A Bankrupt*, unreported judgment, Carney J., 24th March, 1994, noted [1995] Rest. L. Rev. § 221.

[147] *Leiter* v. *Carpenter*, 22 A. 2d 393, 396 (Del. Ch. 1941) ("payment by one only secondarily liable will discharge the debt, so far as the creditor is concerned. But, so far as the primary debtor is concerned, the surety or guarantor making the payment, and who relies on the right of subrogation, is regarded as a purchaser, and the equitable assignee of the debt"); *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945). In *Eastman* v. *Plumer*, 32 N.H. 238, 240 (1855), Perley J. observed of cases of payments by sureties or incumbrancers: "In such cases, though the form of the transaction is payment, and though it operates as payment, so far as to discharge the original debtor from any action on his contract to recover the money, the law keeps the security on foot to protect the equitable interests of the party who has paid his money under such circumstances."

an insurer does not ordinarily discharge a third party who is liable in respect of the insured loss.[148] This is recognised as part of the collateral source rule. As has been seen, Mitchell distinguishes between two types of subrogation, "simple" and "reviving subrogation." In the first case, the payment made by the payer does not discharge the debt or liability owed by the primarily liable party to the "right-holder." In that case, the payer is substituted to the subsisting rights of the right holder against the primarily liable party in order to prevent the enrichment of the right holder by obtaining a double recovery.[149] In cases of reviving subrogation, the payment does discharge the liability of the primarily liable party, and, in order to avoid the enrichment of that party, the payer is substituted to the rights of the right-holder.

2.6 The Assent of the Debtor

It appears that the assent of the debtor or principal debtor is not necessary in order for subrogation to take place.[150] In Roman law, a prior creditor was bound to accept payment if offered to him by a subsequent creditor.[151] The assent of the debtor does not appear to have been material,[152] except in cases where the payer was a stranger to the transaction. In such a case, he could only be subrogated if he had an agreement to that effect with the debtor.[153] Certainly, French law recognises that subrogation takes place by the act of the creditor who is paid, the debtor's consent being immaterial.[154] Indeed, there is no

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[148] *Hart* v. *Western Rail Road Corporation*, 13 Metcalf 99, 105-6 (Mass. 1848); *Fretz* v. *Bull*, 12 How. 466, 469 *per* Wayne J. (U.S. 1851); *The Propeller Monticello* v. *Mollison*, 17 How. (58 U.S.) 153, 156 (1855); *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871); *Wager* v. *Providence Insurance Co.*, 150 U.S. 99 (1893). See also S.F. Dixon, *Substituted Liabilities, A Treatise on the Law of Subrogation* (1862), 152-154, and in particular at 154: "it seems to have been generally understood that as the right of action existed in favor of the party sustaining the injury, the action could only be brought in his name..." The requirement for the insurer to sue in its own name arises from statutes or rules of procedure which provide that every action should be brought in the name of the "real party in interest." On these, see Horn, *op. cit.*, 86-90 and Derham, *op. cit.*, 73-4, 96-7.

[149] *Cf. R.* v. *Bennett* (1810) Wightw. 1, 7 *per* Thomson B., where the inhabitants of a parish were compelled to pay again a tax which had been collected by the tax collector, but for which he was unable to account to the crown. It was held that the tax payers were entitled to the benefit of the crown's rights against the collector, in order to reimburse themselves. The payment by the tax payers had not relieved the collector from liability.

[150] This seems to follow from *Thurstan* v. *Nottingham Permanent Building Society* [1903] A.C. 6, affirming [1902] 1 Ch. 1, *Butler* v. *Rice* [1910] 2 Ch. 277 and *Rogers* v. *Resi-Statewide Corporation Ltd.* (1991) 105 A.L.R. 145; 32 F.C.R. 344. In *Vassos* v. *State Bank of South Australia* [1993] 2 V.R. 316, Hayne J. stated that he did not find it necessary to decide the point. Marshalling is a clear case where the attitude of the debtor is treated as irrelevant.

[151] D. 20.4.11.4 (Gaius). *Cf.* C. 8.18.1: if the subsequent creditor deposited the amount of the prior creditor's claim, on the refusal of the latter to accept payment, he succeeded to the rights of the prior creditor; Dixon, *op. cit.*, 13.

[152] Although Roman law also accepted that payment by a third party with no connection with the debtor could be an effective discharge of the debt: Birks and Beatson, "Unrequested Payment of Another's Debt," chapter 7 in J. Beatson, *The Use and Abuse of Unjust Enrichment* (1991), 177, at 178, note 5. The payer could make an agreement for subrogation with *either* the debtor or the creditor: Dixon, *op. cit.*, 10, referring to Renusson.

[153] Dixon, *op. cit.*, 11, referring to the view of Dumoulin.

[154] Mestre, *op. cit.*, n° 39.

requirement that the debtor even be notified.[155] In the New York case of *Mathews* v. *Aikin*,[156] a voluntary surety who paid the creditor was held entitled to subrogation to his rights, the fact that the principal debtor had not consented either to the surety's contract or payment being irrelevant.[157]

2.7 Subrogation and Contribution

There is an undoubted historical connection between subrogation and contribution. As regards the position of sureties, the two rights seem to have received acknowledgement by the Courts of Chancery and the Exchequer at the same time. The right of subrogation may in most cases be used to enforce a right of contribution. The exception to this is in cases of insurance.[158] It has long been accepted in Ireland and England that the insurer's right to a contribution from other insurer's is the insurer's own right, and does not derive from the insured, and cannot be enforced by way of subrogation.[159] In general, however, in

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[155] *Ibid.*

[156] 1 N.Y. 595 (1848).

[157] *Cf. Owen* v. *Tate* [1976] 1 Q.B. 402, where subrogation was not raised on similar facts.

[158] *Sickness and Accident Assurance Association Ltd.* v. *General Accident Assurance Corporation Ltd.* (1892) 29 S.L.R. 836, 837 *per* Lord Low.

[159] The insurer has his own direct right against other insurers and subrogation to the insured's rights against them would ordinarily lend nothing to this. See *Sydney Turf Club* v. *Crowley* [1971] 1 N.S.W.L.R. 724, discussed in Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 935. The decision seems to have turned on the view that the second insurer had a good defence against the insured arising out of the payment by the first insurer. See also *Austin* v. *Zurich General Accident and Liability Corporation Ltd.* [1945] 1 K.B. 250; *North British and Mercantile Insurance Company* v.

Ireland and England, an insurer's claim for contribution against another insurer is considered to be a "direct" right of action, rather than a right of action arising through subrogation. One reason given for this is that the payment by one insurer extinguishes any right of action the insured might have had against another insurer in respect of the same loss.[160] It has therefore been held that an insurer claiming a contribution from another insurer could claim no rights in respect of a sum which another insurer had received in reduction of its losses: this sum had not been received in reduction of the losses of the insured.[161]

London, Liverpool and Globe Insurance Company (1877) 5 Ch. D. 569, 583; *Sickness and Accident Assurance Association Ltd.* v. *General Accident Assurance Corporation Ltd.* (1892) 29 S.L.R. 836. In *Zurich Insurance Company* v. *Shield Insurance Company Ltd.* [1988] I.R. 174, 177 *per* Gannon J. (who appeared to think that, in theory, an insurer's action for contribution against another insurer was a species of subrogation to the insured's rights; the Supreme Court on appeal did not clearly distinguish between the two doctrines). However, in America, it seems to be accepted that in at least some circumstances, an insurer may be subrogated to the insured's rights against other insurers: see Cozen, "(Property) Subrogation Against One's (Liability) Insured - A Prophylactic Bar That is Legally Insupportable and Intellectually Unsound," (1991) 42 F.I.C.C.Q. 3, 10 note 22. In other situations, such as cases of suretyship or marshalling by apportionment, it is well established that a payer may be subrogated to the payee's rights, which may well be proprietary, against the party liable to contribute.

[160] *Sydney Turf Club* v. *Crowley* [1971] 1 N.S.W.L.R. 724.

[161] *Standard Marine Insurance Company Ltd.* v. *Westchester Fire Insurance Co.* (1938) 60 Ll. L. Rep. 202 (U.S. C.C.A. 2nd).

CHAPTER 3

RESTRICTIONS ON THE AVAILABILITY AND EXTENT OF SUBROGATION

3.1 Subrogation is not available to one who pays a debt for which he is primarily liable

Where a number of persons are liable for the same debt, one on whom the ultimate burden of that debt should fall cannot seek to displace that burden by claiming to have been subrogated to the creditor's rights against one of the other debtors. This is an extension of a general rule that a debtor who pays off a charge on his property may not set that charge up against his own subsequent creditors.[1] Furthermore, where a debtor pays off one of two incumbrances which rank *pari passu*, he is not allowed to raise that which he has paid in competition with the remaining one.[2] Where a person is primarily liable to pay a debt as regards another debtor, but has undertaken no duty to pay it off as against a subsequent secured creditor, he may be held subrogated to the creditor's rights as against the subsequent creditor, though he could not set it up as against the other debtor.[3]

Where a number of parties are liable successively, one whose liability is prior to that of another cannot attempt to shift the burden of the debt onto the latter, either by means of subrogation or assignment. It may be no simple task to establish the proper incidence of liability. Problems are apt to arise in cases of several sureties or parties to negotiable instruments.[4] Thus, in a Scottish case,[5] one party had guaranteed the payment of bills of exchange by the acceptor. Although he received an assignment of the bills from the holder (creditor), it was held that he was not entitled to recover any sum from the estate of an indorser. As the guarantor had intervened to guarantee payment by the acceptor, his liability must have been prior to that of the indorser.[6] In the case of *In re Flick*,[7] it was accepted that each partner was

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[1] Sheldon, *op. cit.*, § 46: "The debtor upon whom rests the ultimate obligation of discharging the debt cannot by his payment acquire any right of subrogation; and if, upon making his payment, he takes an assignment of the security, this will be equivalent to a discharge thereof." (Citations omitted). See also *Platt* v. *Mendel* (1884) 27 Ch. D. 246; *Watts* v. *Symes* (1851) 1 De G., M. & G. 240, 244 (*per* Knight Bruce L.J.: "It is plain that a person who borrows money cannot be his own creditor, or set up an incumbrance of his own against his creditor"); *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638; *Acer* v. *Hotchkiss*, 97 N.Y. 395 (1884); *In re Davison's Estate* (1893) 31 L.R. Ir. 249, 255 *per* Monroe J.; *Parkash* v. *Irani Finance Ltd.* [1970] Ch. 101; *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, 784 *per* Millett L.J.

[2] *In re W. Tasker & Sons Ltd.* [1905] 2 Ch. 587.

[3] See *Clute* v. *Emmerich*, 99 N.Y. 342, 352-3; 2 N.E. 6, 21 (1885), and, in the case of purchasers who assume the payment of an incumbrance, *post*.

[4] See, *e.g.*, *Parsons* v. *Briddock* (1708) 2 Vern. 608; *Craythorne* v. *Swinburne* (1807) 14 Ves. 160; *Schnitzel's Appeal*, 49 Pa. 23, 29 (1865) (bail for stay of execution on a judgment recovered against the principal and original surety, was liable to the original surety, it being held that he had interposed himself between the principal and original surety at the principal's request).

[5] *Johnstone* v. *Inglis' Trustee* (1843) 5 Bell (S.C.) 1396.

[6] On indistinguishable facts, the opposite conclusion was reached in *Scholefield Goodman and Sons Ltd.* v. *Zyngier* [1986] 1 A.C. 562.

jointly and severally liable for the debts of a partnership. However, where one partner had fraudulently incurred a debt on behalf of the partnership, he owed a fiduciary duty to indemnify his co-partner. Therefore, when the honest partner paid the debt incurred by the act of the fraudulent partner, he was entitled to be subrogated to the creditor's rights against the fraudulent partner.

The United States Bankruptcy Code[8] codifies this principle, providing that a payer may not claim to have been subrogated to the creditor's rights against a debtor where "as between the debtor and [the payer], [the payer] received the consideration for the claim held by such creditor." In *In re Russell*,[9] two makers of a promissory note had pledged securities to the payee, who had lent them the funds to buy the securities. One of the makers (the "transferor") had transferred some of the securities to a debtor who assumed the liability to repay a proportionate amount of the loan to the lender. The makers were required to repay the debtor's share of the loan. They claimed to have been subrogated to the lender's lien over the securities to the extent to which the debtor had been liable. The court accepted that the makers had paid a portion of the debt for which the transferor had been primarily liable. The other maker could therefore claim subrogation to the lien to the extent of his payment of the debtor's share of the loan. However the transferor could not claim subrogation on the ground that he had received the consideration for the debt which he had paid, namely that he had initially received the securities. The decision seems wrong: by the assumption agreement, to which the lender had acceded, the debtor had become the person primarily liable, and the consideration had been transferred to him.[10]

3.2 Where the payer pays a debt which he owes, he cannot claim subrogation to the creditor's rights in respect of a distinct claim against a different debtor

An example is the case of *In re Towey, A Bankrupt*,[11] where a collecting bank was found to have been guilty of negligence, and settled claims with the payees of cheques which it had negligently delayed in collecting. The bank then claimed to have been subrogated to the payees' rights against the drawer. It was held that it had not been so subrogated, as its liability to the payees was independent of that of the drawer, even though the payees had in effect been fully compensated by the settlements.

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[7] 75 B.R. 204 (Bkrtcy. S.D. Cal. 1987).
[8] 11 U.S.C. § 509 (b) (2).
[9] 101 B.R. 62 (Bkrtcy. W.D. Ark. 1989).
[10] See also *In re Valley Vue Joint Venture*, 123 B.R. 199, 205; 21 Bankr. Ct. Dec. 513; 13 U.C.C.R. Serv. 2d (Callaghan) 842 (Bkrtcy. E.D. Va. 1991). In *Wetzler* v. *Cantor*, 202 B.R. 573, 577 (D. Md. 1996), it was observed that the statutory provision did not affect claims to subrogation other than under § 509.
[11] Unreported judgment, Carney J., 24th March, 1994.

3.3 A Debtor cannot claim to have been subrogated where there is no other party liable in respect of the same debt to the same Creditor

Although this may seem to be an obvious statement in the abstract, its application can seem less obvious on concrete facts.[12] Two American cases will be taken as examples. In *In re New England Fish Co.*,[13] the marketing agent for a seller of fish entered into a contract of sale with a purchaser. The seller had entered into contracts with processors under which the processors were bound to process the fish to certain standards. The purchaser sued the agent for breach of contract, on the ground that the fish were of too low a standard. The agent settled with the purchaser, and then sought reimbursement from the seller and the processors. The agent claimed, *inter alia*, to have been subrogated to the purchaser's rights against the processors. The court held that the purchaser had never had any rights against the processors to which the agent might have been subrogated, emphasising that a right to subrogation only exists "when the subrogee pays or discharges a debt for which another is primarily liable."[14]

In *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*,[15] B. had procured a favourable judgment on a point of law through fraud. A., as it alleged, in reliance on that judgment, settled an action brought against it by B. through the method of discontinuing an action which it had brought against C., C. in turn forgiving a debt owed it by B. After learning of the fraud, A. claimed that it had been subrogated to C.'s rights against B. However, this was held not to be possible, as, in substance, A. had merely paid B. the debt which it owed it using its own funds.

3.4 The subrogated party can recover no more than he himself paid to the Creditor

This rule seems to derive from Roman law.[16] It is firmly established in French[17] and American law.[18] Therefore, if the surety compromised the creditor's claim, he could recover no more than the

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[12] So, where an insured had in fact no cause of action against a third party, it did not injure the insurer by settling with the third party, and refusing to execute an assignment of its supposed cause of action to the insurer: *Royal Indemnity Company* v. *Pharr*, 93 S.E. 2d 784 (Ga. 1956).

[13] 749 F. 2d 1277 (1984).

[14] 749 F. 2d 1277, 1282 (1984). The court added that "One cannot seek subrogation for paying one's own debts."

[15] 44 A. 2d 11 (Del. Ch. 1945).

[16] D. 20.5.2 (Papinian) referred to a surety who was sued by the creditor, and obtained an order from the judge that "he [the surety] should take over the land mortgaged to the creditor by way of purchase." Nonetheless, a subsequent mortgagee was permitted to buy out the surety by offering him the sum which he had paid the original creditor, with interest. Thus, it was clear that the surety could only enforce the mortgage which had been assigned to him for the *amount which he had paid*, with interest. Also note D. 20.5.5.1 (Marcian) ("If the second creditor or surety pays the money and takes over the property mortgaged, an offer of payment may properly be made to them, although they hold the property by way of purchase") and D. 20.5.6 (Modestinus) ("When a later creditor purchases the mortgage from an earlier, he

amount of the compromise from the principal.[19] Strictly speaking, it seems to be the law in Ireland and England that a subrogated payer *can* sue a third party for the entire of the amount which that party owes or owed to the original creditor. However, the subrogated party is not allowed to profit from the arrangement, and must account to the original creditor for any amount he receives above the sum which he paid to the creditor.[20] He is also allowed to reimburse himself for the amount of costs which he has paid or incurred, and interest on the sum which he paid after the date on which he paid.[21] A separate issue is whether the third party has any right to raise the limit on the subrogated payer's recovery as a defence. In Ireland and England, it seems that the correct answer is usually "no," at least where the third party was not a party to the original contract between the payer and the original creditor.[22] In America, the law may be otherwise.[23]

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is taken to have done so not to acquire the ownership but to preserve his own mortgage. Hence, the debtor may make him an offer of payment").

[17] Mestre, § 23.

[18] Where it has been described as the "First Principle of Subrogation": Quinn, "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1374. See, *e.g.*, *Associated Hospital Service of Philadelphia* v. *Pustilnik*, 497 Pa. 221, 226; 439 A. 2d 1149, 1151 (1981), reversing 262 Pa. Super. 600; 396 A. 2d 1332 (1979).

[19] *Etter* v. *Industrial Valley Bank and Trust Co.*, 515 A. 2d 6, 8 *per* Beck J. (Pa. Super. 1986); *allocatur* denied 524 A. 2d 494 (Pa. 1987), referring to *Bishoff* v. *Fehl*, 345 Pa. 539; 29 A. 2d 58 (1942); *Tooks* v. *Indemnity Company of North America*, 381 Pa. 607; 114 A. 2d 135 (1955); *Restatement of Security* (1941), § 104 comment (d); *Restatement of Restitution* (1937), § 80 comment (a).

[20] *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330. It has further been held that the subrogated payer holds the surplus beyond what he requires for his own indemnification subject to a constructive trust in favour of the original creditor: *Lonrho Exports Ltd.* v. *Export Credit Guarantee Department* [1996] 2 Lloyd's Rep. 649. If the insured *abandons* property to the insurer, the latter is entitled to exercise all proprietary rights arising from the property, which may result in a profit for him: *Lucas* v. *Export Credit Guarantee Department* [1973] 1 W.L.R. 914, 924 *per* Megaw L.J.; *Page* v. *Scottish Insurance Corporation* (1929) 33 Ll. L. Rep. 134, 575 *per* Scrutton L.J.

[21] *H. Cousins & Co. Ltd.* v. *D. & C. Carriers Ltd.* [1971] 2 Q.B. 230, 242 *per* Widgery L.J. See Simpson, "Cargo Insurer's choice between Subrogation, Equitable Assignment and Legal Assignment in proceedings in Hong Kong," [1997] L.M.C.L.Q. 129, 141, who cites also *Fisher* v. *Keller Industries*, 485 N.W. 2d 626 (1992). For the situation of sureties, see, *e.g.*, *Executors of Fergus* v. *Gore* (1803) 1 Sch. & Lef. 107; *Butcher* v. *Churchill* (1808) 14 Ves. 567, 576; *Scottish Provident Institution* v. *Conolly* (1893) 31 L.R. Ir. 329.

[22] Mitchell, "Defences to an Insurer's Subrogated Action," [1996] L.M.C.L.Q. 343, 344-348, discussing the difficulties which a third party may have in objecting to a subrogated insurer's right to sue, where the subrogating insured is the plaintiff on record. See also *Craydon's Pharmac, Ltd.* v. *Standard Paving Co.* [1973] 3 O.R. 435, noted [1974] L.M.C.L.Q. 95, where it was held that the fact that the insurer had indemnified the insured for damage to goods, and then sold the goods at a salvage value, was not evidence of the damage caused by the tortfeasor.

[23] *Cf.* Quinn, *op. cit.*, at 1374-1376. In the old Admiralty case of *Fretz* v. *Bull*, 12 How. 466 (U.S. 1851), the Supreme Court held that an action could be brought in the name of the insured where the insured had not been fully indemnified by the insurer. It was argued by the defendant that the insurer, which, it was said, should have sued in its own name, could even then have recovered no more than it had paid. The court must be taken to have rejected this argument.

One reason given for the rule is that the payer's intention must be taken to have been to act on behalf of the debtor.[24] In *Reed* v. *Norris*,[25] Lord Cottenham L.C. rationalised the rule by likening the surety to a fiduciary, stating that the surety entered into his obligation on behalf of the principal, and was subject to a duty to obtain the best possible terms for him. Because of this relationship, the surety could not be allowed to treat his payment as a purchase of the debt, which would have entitled him to claim the full amount of it, if he had paid less.[26] Similarly, it has been said that the surety's recovery was limited, in order to prevent him from speculating with the interests of the principal debtor.[27]

By contrast, an assignee may claim for the entire amount of the assigned claim.[28] Also, where property is abandoned to an insurer, he is entitled to the entire of its worth, even if this exceeds the amount which he paid to the insured.[29] In *Bernardini* v. *Home and Automobile Insurance Co.*,[30] the court distinguished subrogation from assignment on the ground that the former operated only to secure indemnification or contribution,[31] while an assignment transferred an entire claim. In the Florida case of *DeCespedes* v. *Prudence Mutual Casualty Co.*,[32] a court upheld the validity of an express subrogation clause in the medical expenses provision of a motor insurance policy. The court stated that

> "[u]nder the doctrine of subrogation, the insurer is *substituted*, by operation of law, to the rights of the insured. It is not available to a volunteer, only to one under a duty to pay. Furthermore, it is not available to an extent greater than the amount paid by the insurer, and then only after the insured has been fully indemnified.[33] By contrast, an assignment generally refers to or connotes a voluntary act of *transferring* an interest."[34]

The court noted that subrogation would limit the chances of double recovery or a windfall profit to the insured. It would also place the primary liability where it ought to be, on the tortfeasor.

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[24] Duranton, XII, no. 117 note, referred to by Dixon, *op. cit.*, 67.
[25] (1837) 2 My. & Cr. 361.
[26] (1837) 2 My. & Cr. 361, 374-5.
[27] *Etter* v. *Industrial Valley Bank and Trust Co.*, 515 A. 2d 6, 8 *per* Beck J. (Pa. Super. 1986); *allocatur* denied 524 A. 2d 494 (Pa. 1987).
[28] See, *e.g.*, Simpson, *op. cit.*, at 141-142. But compare *Hill* v. *Brown* (1844) 6 Ir. Eq. R. 403, where it was held that a life tenant who had paid off an incumbrance on the inheritance, and obtained an assignment for his benefit, would not be permitted to claim more on foot of it than he had paid. The reason for the decision may perhaps be that a life tenant could not be permitted to speculate with the value of an incumbrance as against his remaindermen.
[29] *Page* v. *Scottish Insurance Corporation* (1929) 33 Ll. L. Rep. 134, 575; Derham, *Subrogation in Insurance Law* (1985), 17; Mitchell, *The Law of Subrogation* (1994), 43.
[30] 64 Ill. App. 2d 465; 212 N.E. 2d 499 (1965).
[31] It should be noted that subrogation is not normally available to enforce an insurer's right of contribution against another insurer. See section 2.6, *ante*.
[32] 193 So. 2d 224 (Fla. 1966), affirmed 202 So. 2d 561 (1967).
[33] Accepting that the *nemo contra se censetur* rule applies. See section 2.3.d, *ante*.

The limit on the subrogated party's recovery renders subrogation unattractive as a means of speculation; if such was the motive for payment, the payer should have procured an assignment of the creditor's right of action. French lawyers have romantically described subrogation as an institution of friendship, which should not permit any element of speculation.[35] The bank which receives payment from the surety may entertain warm feelings towards him. Whether there is any degree of reciprocation is another matter.

3.5 Clean Hands

There exist American cases where the courts applied a rule that one who "seeks the benefit of the equitable doctrine of subrogation" had to come into court with clean hands.[36] This doctrine seems to have been applied primarily in cases where a purchase was set aside as fraudulent, and the purchasers were held not to have been subrogated to the benefit of liens on the property which they had discharged in the meantime.[37] In these cases, subrogation seems clearly to have been envisaged as a remedy which could be withheld from an unmeritorious claimant. There are, however, other statements which seem to envisage a broad judicial discretion as to whether or not to "allow" subrogation.[38] While these statements are quoted often enough,[39] it seems rare for a claimant in one of the accepted categories of persons who are entitled

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[34] At 227.

[35] Mestre, *op. cit.*, §§ 23, 552-557. At § 23, Mestre quotes Demolombe, *Cours de Code Napoléon* (1881), XXVII, n° 323: "cession-transfer is a sale, a commutative contract in which each of the parties has a speculative goal. The character of subrogation is very different. The intention which prevails there is quite otherwise: it is generally a benevolent intention! He who pays another's debt with subrogation does not mean to acquire in order to gain; he only wishes not to lose." The comment of Mestre, *loc. cit.*, is "How, in these conditions, can one not see in personal subrogation an institution of equity *par excellence*."

[36] Sheldon, *op. cit.*, § 44.

[37] *Railroad Company* v. *Soutter* 13 Wallace (U.S.) 517; 20 L. Ed. 543 (1872); *Guckenheimer* v. *Angevine* 81 N.Y. 394 (1880) (purchaser under sale voidable for fraud was not entitled to set up a tax lien which he had paid as against the vendor who sued to rescind, as the taxes had been paid in order to assist the fraud; the purchaser could not avail of subrogation to relieve him from a loss caused by his own unlawful act); Sheldon, *loc. cit.*

[38] *Beaver County* v. *Home Indemnity Corporation*, 88 Utah 1, 36-7; 52 P. 2d 435, 450-1 (1935): "[s]ubrogation is not a matter of right but may be invoked only in those circumstances where justice demands its application, and the rights of the one seeking subrogation have a greater equity than the one who opposes him"; *Transamerica Insurance Co.* v. *Barnes*, 29 Utah 2d 101, 105; 505 P. 2d 783, 786 (1972): "Subrogation is not permitted where it will work any injustice to others"; *In re Chipboard Products Ltd. (in liquidation)*, unreported, 1984 No. 7316 P, 20th October, 1994, at 11: "this right is an equitable one and the granting of it is at the discretion of the court which will allow it only when satisfied that to do so is likely to achieve justice between the debtor and its guarantor" (*per* Barr J.). Also, *Sullivan* v. *Naiman*, 32 A. 2d 589, 591 (N.J. 1943) ("Subrogation is a device of equity, imported from the civil law, to serve the interests of essential justice between the parties"); *Leiter* v. *Carpenter*, 22 A. 2d 393 (Del. Ch. 1941); *Eastern States Petroleum Co. Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945). *Cf.* also *Wagner* v. *Elliott*, 95 Pa. 487 (1880) (see section 7.10, *post*).

[39] *Transamerica Insurance Co.* v. *Barnes*, 29 Utah 2d 101, 105; 505 P. 2d 783, 786 (1972); *Educators Mutual Insurance Association* v. *Allied Property and Casualty Insurance Co.*, 890 P. 2d 1029, 1031 (Utah 1995).

to subrogation, to fail on this ground alone. Other courts have denied any general discretion to "refuse" subrogation.[40]

One may compare the recent Northern Irish case of *Stronge* v. *Johnston*,[41] where Girvan J. set aside a transfer of land on the ground that it was an unconscionable bargain. The transferee had paid off a mortgage on the property. Girvan J. stated that he who sought equity must do equity, and hence, the transferor had to reimburse the transferee for the sums so paid. He stated that "[h]e who discharges another's secured obligation, wholly or in part, is entitled to be repaid out of the security the amount of the sum or sums paid by him." Capper[42] criticises the decision on this point, on the basis that if there can be an objection to holding that an officious payer of another's debt is subrogated, the same objection should apply where the payer had acted "dishonourably." He states that a better ground on which the same result might have been achieved would have been to grant the relief of setting aside the transfer on terms designed to ensure *restitutio in integrum*. It is felt that even if the proposition enunciated by the judge is over-broad, it was a reasonable decision to hold the transferee to have been subrogated, as his payments were made in the belief that he was owner (which has been held in other cases to be a sufficient basis on which to hold that a payer has been subrogated).[43] His unconscionable behaviour, though a ground for setting aside the transaction, should not be regarded as vitiating the entitlement he would otherwise have to obtain the benefit of the mortgage.

Where a surety paid a creditor using trust funds misappropriated from the principal debtor, it was held that such a payment could give no right of subrogation, Parker L.J. comparing the situation to one paying to the principal debtor on his own behalf money which he owed the principal debtor.[44] There are also occasional *dicta* to the effect that subrogation is only to be "administered" where it would not prejudice the rights of others.[45] This rule is often applied in cases of marshalling, though it is not always clear who will qualify as a person whose rights must not be prejudiced.[46]

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[40] *Bankers Trust Company* v. *Namdar*, unreported, Court of Appeal of England and Wales, judgment delivered 14th February 1997, *per* Peter Gibson L.J.:

> "Subrogation is an equitable remedy which the court allows in a number of differing circumstances to reverse the unjust enrichment of a party. The court has no general discretion whether to give the remedy, but does so in recognised circumstances which make it unconscionable for that party to deny the proprietary interest claimed by another party."

[41] Unreported, High Court, Chancery Division, Girvan J., 16th April 1997, 1996 No. 1534, discussed by Capper, "The Debtor, the Wife, the Farm and the Opportunist," (1997) 48 N.I.L.Q. 400.
[42] "The Debtor, the Wife, the Farm and the Opportunist," (1997) 48 N.I.L.Q. 400, 404.
[43] Section 4.8.b, *post*.
[44] *Derek Randall Enterprises Ltd. (in liq.)* v. *Randall* [1991] B.C.L.C. 379, 390 *per* Parker L.J.; 391 *per* Stocker L.J.
[45] *Miller* v. *Holland*, 84 Va. 652, 659; 5 S.E. 701 (1888). It was there held that a transferee of Whiteacre, which was liable to indemnify Blackacre against A.'s lien affecting both, could not be subrogated to A.'s rights against Blackacre, as Whiteacre, in his own hands, was primarily liable to pay A.'s lien. This really

3.6 The subrogated party acquires no greater right than the party for whom he is substituted

This is axiomatic, and is inevitable if one applies the metaphor of substitution literally. If the payer or lender's feet are bigger than those of the creditor into whose shoes he steps, he must bear his discomfort. Those who favour a restitutionary analysis might say that the amount of the enrichment received or likely to be received by the debtor is measured by the extent of the rights of the creditor whose claim has been paid.[47] Examples occur in each context where subrogation has been applied. A few will be given here.

It is trite law that the insurer acquires by subrogation no better right than the insured to whose place he is substituted.[48] This is all the more apparent in jurisdictions such as Ireland and England, where the insurer is required to sue in the name of the insured. Thus, if the insured had contractually waived a right of action against a third party, the insurer, having paid the insured, is similarly precluded from recovering against the third party.[49]

In *In re Manchester, Middleton and District Tramway Co*,[50] the directors of a company established by statute had requested the "Globe" company to advance money to solicitors and parliamentary agents in order to procure the passage of a further Act relating to the company. Kekewich J. seems to have held that this was beyond the company's powers. The Globe company then claimed that it had been subrogated to the solicitors' rights against the company. Kekewich J. stated:

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amounts to no more than an application of the rule that a principal debtor may not claim subrogation on paying his own debt (see *ante*), although here Whiteacre itself, rather than the owner of it for the time being, was the "principal debtor." The facts were an example of the "inverse order of alienation" rule of liability of parcels of land subject to a common incumbrance alienated at different times. See section 12.3.a, *post*.

[46] See section 12.3, *post*.

[47] Although, as has been seen in section 3.4, *ante*, another limitation is that the payer can recover no more by means of subrogation than he himself paid.

[48] *Simpson* v. *Thompson* (1877) 3 App. Cas. 279; *Employers Liability Assurance Corporation* v. *Haidt*, 6 N.J. 471; 79 A. 2d 308 (1951); *Insurance Company of North America* v. *Carnahan*, 446 Pa. 48, 50; 284 A. 2d 728, 729 (1971); *Hartford Fire Insurance Co.* v. *Riefolo Construction Co.*, 81 N.J. 514, 524; 410 A. 2d 658 (1980); *Aetna Insurance Co.* v. *Gilchrist Brothers*, 85 N.J. 550, 560-1; 428 A. 2d 1254 (1981); *Travelers Insurance Company* v. *Commercial Union Insurance Company*, 335 S.E. 2d 681, 684 (Ga. App. 1985); *Orselet* v. *DeMatteo*, 206 Conn. 542, 546-7; 539 A. 2d 95 (1988); *Republic Insurance Co.* v. *Paul Davis Systems of Pittsburgh South, Inc.*, 670 A. 2d 614, 615 note 1 (Pa. 1995); *Wilkinson* v. *Boats Unlimited, Inc.*, 670 A. 2d 1296 (Conn. 1996).

[49] For example, note the numerous cases on the "benefit of insurance," under which the insured contracts to obtain insurance for the benefit of himself and the third party; this is construed to be a waiver of his rights against the third party. See, *e.g.*, *Phoenix Insurance Company of Brooklyn* v. *Erie and Western Transportation Company*, 117 U.S. 312; 6 S. Ct. 750; 29 L. Ed. 873, 880 (1886); *Wager* v. *Providence Insurance Co.*, 150 U.S. 99; 14 S. Ct. 55; 37 L. Ed. 1013, 1017 (1893).

[50] (1893) 68 L.T. 820.

"Granted that they are subrogated to the rights of the persons to whom the money was paid, they cannot be in any better position than those persons, and my decision is that the latter could not themselves sue the company."[51]

So, where the original creditor's action was time-barred, this was also a bar to an action by the payer, which had been subrogated to the creditor's rights, even though the payer would not have been barred if it had been able to claim in its own right.[52]

The requirement that the subrogated party can acquire no greater interest than that of the party to whose place he is substituted distinguishes subrogation from the direct imposition of an equitable lien. Thus, in cases where such a lien has been imposed, as, for instance, in cases of salvage, it has never been considered necessary that the creditor paid off by the claimant had himself a lien or other proprietary right over the property in which the claimant had an interest.[53]

The fact that the subrogated party can acquire no greater rights than those of the party to whose position he is substituted does not, however, mean that he must automatically acquire all the rights of the latter party.[54]

3.7 The Subrogated party must be identified with the party to whose place he is substituted

Again, this is axiomatic, and seems to be an inevitable consequence of the use of the metaphor. One important consequence is that proceedings taken by either the subrogated party or the original creditor to whose place it is substituted will be binding on the other. Thus, judgment delivered by a court

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[51] (1893) 68 L.T. 820, 826. Similarly, in *Thurstan* v. *Nottingham Permanent Building Society* [1902] 1 Ch. 1, affirmed [1903] A.C. 6, Romer L.J. stated that a building society which had advanced money under a void contract to an infant, for, *inter alia*, the purposes of building on land, would have been subrogated to any lien which the builders had had on the land, but they had none. See also *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732. In *Halifax Mortgage Services Ltd.* v. *Muirhead* (1997) 76 P. & C.R. 418, the Court of Appeal of England and Wales refused to to permit the enforcement of a mortgage to which the plaintiff had been subrogated until the amount due on foot of it had been determined. The amount secured by that mortgage was far less than the loan made by the plaintiff to the borrower. Since the making of that loan, the borrower and his wife had paid more than the amount originally secured by the original mortgage. The court therefore directed that the trial judge should determine if any amount remained due on that mortgage.

[52] *Holloway* v. *State of New Jersey*, 593 A. 2d 716, 720-722 (N.J. 1991).

[53] See section 4.6.a, *post*.

[54] In *Vassos* v. *State Bank of South Australia* [1993] 2 V.R. 316, a mortgagee had obtained a valid mortgage, even though it bore the forged signatures of two of the three apparent co-mortgagors. The mortgage was for a large sum, part of which had been paid in discharge of an earlier mortgage for a smaller sum. The co-mortgagors whose signatures had been forged claimed that, notwithstanding the validity of the mortgage which the mortgagee had received, it had nonetheless been subrogated to the rights of the prior mortgagee, and could enforce its mortgage for no more than was secured by the earlier mortgage. This argument was rightly rejected.

of competent jurisdiction in proceedings involving one party will have the weight of *res judicata* as regards other proceedings involving the same issue where the other party is concerned.[55] In *McGuinness* v. *Motor Distributors Ltd.*,[56] a party had had his interest as defendant in personal injury proceedings (where he sued a third party for a contribution) controlled by an insurer. Barron J. nevertheless held that the earlier judgment in the third party proceedings rendered *res judicata* separate proceedings where the former defendant sued the former third party for damages for breach of contract arising out of the same incident. The decision was affirmed on appeal *ex tempore* by the Supreme Court.[57]

Furthermore, for the purposes of Article 21 of the Brussels Convention, proceedings involving one party in a contracting State may be deemed to be proceedings involving a party subrogated to its rights, with the effect that a court in another contracting State must refuse jurisdiction over proceedings involving the other party. This is illustrated by a decision by the Fifth Chamber of the Court of Justice of the European Union. In *Drouot Assurances S.A.* v. *Consolidated Metallurgical Industries*,[58] the insurer of the hull of a vessel which had foundered, paid to have the vessel refloated. C.M.I., the owner of the cargo laden on board, and the cargo insurer, brought proceedings in the Netherlands, claiming a declaration that they were not obliged to make a general average contribution to the hull insurer. They brought those proceedings against the apparent owner and the charterer of the vessel. Three months later, the plaintiff, the hull insurer, brought these proceedings in France against C.M.I. and the cargo insurer, seeking a general average contribution from one or other of those parties. Those defendants raised a plea of *lis alibi pendens*, with reference to the proceedings they had brought in the Netherlands. At first instance, this plea was rejected, on the ground that the plaintiff insurer had not been a party to the proceedings in the Netherlands. On appeal, it was held that the insurer had been a party to the Dutch proceedings through the intermediary of its insured. On reference to the Court of Justice, the Fifth Chamber held that

> "there may be such a degree of identity between the interests of an insurer and those of its insured that a judgment delivered against one of them would have the force of res judicata as against the other. That would be the case, inter alia, where an insurer, by virtue of its right of

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[55] *E.g.*, *Travelers Insurance Company* v. *Commercial Union Insurance Company*, 335 S.E. 2d 681 (Ga. App. 1985): the owner of a vehicle sued the employer of a driver of another vehicle. Although the employer was held liable, a jury awarded no damages. It was held that the owner's insurer was bound by this judgment, and precluded from recovering any sum from the employer's insurer. An example from the same jurisdiction in a different context is *McCollum* v. *Lark*, 187 Ga. 292; 200 S.E. 276 (1938), where a lender had agreed with the borrower that the funds lent would be used to pay a prior lien on the borrower's property. It was held that a consent judgment in proceedings between the prior creditor and a subsequent creditor, establishing the priority of the former's lien, remained binding on the latter, as against the lender, when it was subrogated to the prior creditor's rights.

[56] [1997] 2 I.R. 171.

[57] (O'Flaherty, Murphy and Lynch JJ.) Judgment delivered on the 17th July 1997.

[58] [1999] 2 W.L.R. 163.

subrogation, brings or defends an action in the name of its insured without the latter being in a position to influence the proceedings."[59]

In such circumstances, the insurer and insured had to be regarded as being one for the purposes of Article 21 of the Brussels Convention. Furthermore, where the respective interests of insurer and insured diverged, they could be precluded from asserting those respective interests as against other parties. However, it was not necessarily the case that the insured and insurer had to be treated as the same party. The test was whether the interests of the two were identical and indissociable. The case was remitted to the national court for a conclusion.[60]

In a Connecticut case, it was held that the court could only have had jurisdiction if the plaintiff had had a place of business within the State. The plaintiff was the insured which had been indemnified by the insurer, which was bringing proceedings by way of subrogation. The fact that the *insurer* had been carrying on business within the State at the time of initiation of litigation did not confer jurisdiction where the insured nominal plaintiff would not have had standing in his own right.[61]

3.8 The "Volunteer" Rule

There is a hoary rule, repeated mantra-like, that subrogation is not available to a volunteer.[62] This only applies to legal subrogation. If a payer agrees with a creditor or debtor that, on payment of the debt, he should succeed to the rights of the creditor, then no issue of voluntariness arises.[63] In the United States, it appears that one will not be regarded as a volunteer if one pays either (a) on foot of a legal or moral

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[59] [1999] 2 W.L.R. 163, 179.

[60] A similar decision is *The "Linda"* [1988] 1 Lloyd's Rep. 174, 179 *per* Sheen J., where it was held that an action brought in the name of the insured in England had to be regarded as brought by the same party as one instituted by the insurer in respect of the same cause of action in the Dutch courts. Hence, the English action had to be stayed.

[61] *Wilkinson* v. *Boats Unlimited, Inc.*, 670 A. 2d 1296 (Conn. 1996).

[62] See, *e.g.*, Sheldon, *op. cit.*, § 240: "The doctrine of subrogation is not applied for the mere stranger or volunteer who has paid the debt of another without any assignment or agreement for subrogation, being under no legal obligation to make the payment and not being compelled to do so for the preservation of any rights or property of his own." That passage was cited with approval in *Campbell* v. *Foster Home Association*, 163 Pa. 609, 636; 30 A. 222, 225; 26 L.R.A. 117; 43 Am. St. Rep. 818 (1894), *Contoocook Fire Precinct* v. *Hopkinton*, 71 N.H. 574, 578; 53 A. 797, 799 (1902), *Mitchell* v. *Smith's Estate*, 4 A. 2d 355, 358 (N.H. 1939), *In re Account of Commonwealth Trust Co., Trustee (No. 1)*, 247 Pa. 508, 515; 93 A. 766, 768 (1915) and *Beck* v. *Beiter*, 146 Pa. Super. 114; 22 A. 2d 90, 93-4 (1941). See similarly, *Michigan Millers Mutual Insurance Co.* v. *United States Fidelity and Guaranty Corporation*, 306 Pa. Super. 88, 92; 452 A. 2d 16, 18 (1982). Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 226, observes that the "principle" that a volunteer was not entitled to subrogation "has never provided a clear or coherent means of limiting the ambit of subrogation since the concept of the volunteer has ... seldom been successfully defined in the cases" (annotation omitted). However, she argues that the volunteer principle represented an unjust enrichment analysis in nascent form. In other words, the supposed volunteer was someone who could not point to an unjust factor.

[63] *Cf. Contoocook Fire Precinct* v. *Hopkinton*, 71 N.H. 574, 578; 53 A. 797, 799 (1902).

obligation,[64] or (b) in order to protect one's own interests. In England and Ireland, payment under a legal obligation will not be regarded as voluntary,[65] at least where the obligation was not itself incurred voluntarily.[66] The proper characterisation of payments made under a "moral obligation" is more troublesome.[67] The characterisation of self-interested payments is controversial in England.[68] In Ireland, such payments have in the past been regarded as proper to ground proprietary relief.[69]

In *Aylwin* v. *Witty*,[70] a surety for the payment of premiums on a mortgaged insurance policy requested a third party to pay some of the premiums, and purported to assign his interest in the policy to the third party. It was held that this was effective to permit the third party to have the benefit of the lien which the surety would have had if he had paid out of his own funds. Kindersley V.-C. added: "Even if [the third party] had paid them voluntarily, he had gained such an interest as justified him in seeing that they were kept up; and the creditors cannot take the money and deprive him of those payments."[71] Later English cases cast doubt on the correctness of this as a general comment.[72] Certainly, in *Aylwin* v. *Witty*, the third party had been requested to make the payment by the surety, who was under an obligation. Thus, the payment does not seem to have been an unsolicited intervention, and Kindersley V.-C.'s comments were clearly *obiter*.

The application of the volunteer rule will now be considered in a number of the contexts where subrogation has been applied.

3.8.a Case of Surety who becomes bound without request from the Principal Debtor

Ordinarily, a surety will become bound at the request of a principal debtor. In the rare cases where he does not, an issue may arise as to his entitlement to seek indemnification from the principal debtor. Under the Roman law, one who became surety without the request of the principal was permitted to recover the amounts which he spent from the principal.[73] However, if one became surety against the instructions of the principal debtor, one could not recover from him on either action.[74]

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[64] *Campbell* v. *Foster Home Association*, 163 Pa. 609, 636; 30 A. 222, 225; 26 L.R.A. 117; 43 Am. St. Rep. 818 (1894): "Subrogation will not be decreed in favor of a mere volunteer who without any duty, moral or otherwise pays the debt of another."
[65] See section 4.4, *post*.
[66] *I.e.*, by assuming a liability by choice, without the request of the debtor.
[67] See section 4.5, *post*.
[68] *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234; *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 402 *per* Scott V.-C.
[69] See section 4.6, *post*.
[70] (1861) 30 L.J. Ch. 860.
[71] (1861) 30 L.J. Ch. 860, 861.
[72] See the cases discussed in section 4.6.d, *post*.
[73] Under later Roman law, two principal forms of suretyship existed (see notes to section 1.4, *ante*). The obligation of a *mandator* was regarded as separate from that of the principal. In case of *fideiussio*, the

The French Civil Code expressly envisages one becoming surety for another without his request, and even without his knowledge.[75] Such a surety is granted a right of indemnification from the principal, although one author suggested, logically, that, as the surety's right in such a case was grounded on his management of the principal's affairs, his recovery should be limited to the amount of the benefit conferred on the principal.[76]

Most American cases seem to refuse any right to reimbursement to a surety who undertakes his obligation without the request of the principal debtor.[77] However, American courts generally take the view

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surety's obligation was secondary to that of the principal. In general, a *fideiussor* was entitled to be indemnified by the principal debtor by action of mandate (contract) if the principal had requested him to become surety. Gaius, I. 3.127; D. 50.17.60 (Ulpian); R. Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), 133. The *mandator* required a cession of the creditor's actions (effectively, subrogation) before he could claim against the principal debtor. Thus, Ulpian stated that

> "[I]f I have allowed someone to give a verbal guarantee on my behalf, or to stand surety for me in some other way, I am liable [to an action] on mandate, and unless the party gave his guarantee against my will either with the intention of making a gift or as an unsolicited administration of my affairs, the action on mandate will lie."

(D. 17.1.6.2). See also D. 17.1.11 (Pomponius); D. 46.1.69 (Tryphoninus); I. 3.20.6; J. Voet, *Commentary on the Pandects* (translated by P. Gane, *sub tit.* "*The Selective Voet, being the Commentary on the Pandects*," VII, 1957), 46.1.9; 46.1.31. Where one became a *fideiussor* without the consent of the principal, but not against his expressed will, although one could not succeed on an action on mandate against him, still the surety could claim against him as an unsolicited administrator (*negotiorum gestor*): D. 17.1.20.1 (Paul). A *mandator* had no recourse against the principal debtor unless the creditor ceded his actions to him. Also, where one became a *mandator* without the assent of the principal debtor, one could not bring an action against him on the management of his affairs, as the *mandator* had technically managed *his own affairs*, rather than those of the principal: D. 17.1.28 (Ulpian); D. 5.3.31 pr. (Ulpian); Voet, *op. cit.*, 3.5.13; 46.1.30. Thus, the only way in which the *mandator* could obtain relief in that case was by obtaining a cession of the creditor's action against the principal from the creditor: Voet, *op. cit.*, 46.1.30. See also D. 46.1.13 (Julian). Voet, *op. cit.*, 46.1.31; H. Grotius, *The Jurisprudence of Holland*, translated by R.W. Lee (1924), 3.3.31; J. van der Linden, *Institutes of Holland*, translated by Sir H. Juta (3rd ed., 1897), 122 (ch. 14, § 10); R.W. Lee, *An Introduction to Roman Dutch Law* (5th ed., 1953), 316.

[74] D. 17.1.40 (Paul). Voet, *op. cit.*, 46.1.33, notes that this was the Roman law, but states that the custom of his day was otherwise.

[75] Article 2014(1) of the Civil Code states that "one may become surety without the request of one for whom one becomes bound, and even without his knowledge." P. Simler, *Cautionnement et Garanties Autonomes* (2nd ed., Éditions Litec, Paris, 1991), n° 14, notes that such cases are rare, but not inconceivable.

[76] Article 2028 of the Civil Code conferred the right of reimbursement on all sureties, whether they undertook their liability at the request of the principal or not. Simler, *op. cit.*, n° 529, suggested the limitation on the surety's right of recovery. He notes that where one becomes surety against the will of the principal, there should be no ground for recovery. For the older French law, *cf.* M. Pothier, *A Treatise on the Law of Obligations or Contracts* (translation, W.D. Evans, 1806), I, 277, § 429: "If the surety is obliged for the principal debtor without his knowledge, he cannot have an action *mandati* against him, but an action *contraria negotiorum gestorum*, which has the same effect."

[77] *Indemnity Insurance Company of North America* v. *McClure*, 191 Minn. 576; 254 N.W. 913 (1934) (surety in bond indemnifying bank against loss arising from misconduct of bank officer denied

that a voluntary surety or guarantor is nonetheless entitled to be subrogated to the creditor's rights against the principal.[78] In *Mathews* v. *Aikin*,[79] a surety who had undertaken his obligation at the request of the creditor, without request by the principal debtor, was held entitled on payment to an assignment of the mortgage held by the creditor over the principal's property in order to secure the payment of the debt. The court said that even if the surety had been a volunteer as against the principal debtor, he was not as regarded the creditor, and there was therefore no reason why the case fell outside the general rule that a surety, on paying the creditor, was entitled to the benefit of all securities held by the latter.[80]

The earliest English case on point concerned a *del credere* guarantee given by an insurance broker, by which he guaranteed to the insured the solvency of an underwriter, without the knowledge or assent of the underwriter.[81] The guarantor paid the insured the amount of a total loss, and then tried to set-off the amount he had so paid against the underwriter's claim for unpaid premiums. It was held that he was not entitled to do so. Lord Ellenborough C.J. stated: "As to compulsion of law, it was a compulsion of [the guarantor's] own seeking, which arose out of their own voluntary act ... no person can, by payment under a voluntary contract acquire a right against a stranger which he had not before; the distinction is if it is by compulsion."[82] However, it seems that if the broker insured *in his own name*, as if he were the insured, then he would be entitled to recover from the underwriter.[83] In *Hodgson* v. *Shaw*,[84] which did not

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indemnification from officer, who had not assented to the bond, and had not known of its existence); *Howell* v. *Commissioner of Internal Revenue*, 69 F. 2d 447, 451 (8th Cir., 1934) (the principal holding of the case, however, was that the plaintiff was an indemnitor, who could have no recourse against the debtor against whose default he indemnified a creditor, unless he had an express contractual right to that effect).

[78] *Carter* v. *Jones*, 5 Iredell's Eq. 196; 49 Am. Dec. 425 (N.C. 1848) (held, that although the surety could not recover at law in an action for indemnification, yet, having paid the bond which he had guaranteed without the knowledge of the debtors, he was to be regarded in equity as a purchaser of it, and entitled to sue the debtors on it, though he was required to join the creditor as a co-plaintiff in the action); *Hecker* v. *Mahler*, 64 Ohio St. 398; 60 N.E. 555 (1901); *Howell* v. *Commissioner of Internal Revenue*, 69 F. 2d 447, 451 (8th Cir., 1934).

[79] 1 N.Y. 595 (1848); see Dixon, *op. cit.*, 76-7.

[80] 1 N.Y. 595, 602 (1848) *per* Johnson J.

[81] *Cumming* v. *Forrester* (1813) 1 M. & S. 494.

[82] (1813) 1 M. & S. 494, 499-500. In *Koster* v. *Eason* (1813) 2 M. & S. 112, 119, the same judge again said of the *del credere* guarantors in that case: "Their guaranteeing [the principal debtor's] solvency to the assured [creditor] is a transaction to which he is wholly a stranger, and from signing the policies in the names of the assured to them as brokers [the guarantors] he [the assured] has not authorised [them] by means of their guarantie given by them to the assured (of which he was not privy) to claim and exercise the rights of [the assured] against him."

[83] In *Koster* v. *Eason* (1813) 2 M. & S. 112, 116, Lord Ellenborough C.J. said: "if [the guarantors] had paid [their customers], they could in their own names, and on their own account, and without any control from the [customers], enforce payment." By permitting them to enter into the contracts (insurance policies) in their own names, the principal debtor (broker) had consented that they should be entitled to act in all respects as creditors. But, as regarded policies in the names of their customers, they could only sue in the names of the customers, upon payment by them to their customers. Also, *Wienholt* v. *Roberts* (1811) 2 Camp. 586; *Parker* v. *Beasley* (1814) 2 M. & S. 423, 427; *Morris* v. *Cleasby* (1816) 4 M. & S. 566, 572-5; *Peele* v. *Northcote* (1817) 7 Taunt. 478; *Leverick* v. *Meigs*, 1 Cowen 645, 663 (N.Y. 1824); *Lee* v. *Bullen* (1858) 27 L.J.Q.B. 161.

[84] (1834) 3 Mylne & K. 183.

concern a *del credere* guarantee, Lord Brougham L.C. said *obiter* that the fact that a surety was bound jointly with the principal debtor proved the principal debtor's consent to payment by the surety: "This is necessary for enabling any man who pays another's debt to come against that other, because a person cannot make himself the creditor of another by volunteering to discharge his obligations."[85]

In a more modern case, on the other hand,[86] Greene L.J. stated, *obiter*, that the case of a guarantee given without any antecedent request by the principal debtor was "merely one example of a number of cases where the law raises an obligation irrespective of any antecedent contractual relationship between the parties."[87] The implication of this is that he thought that the surety would nonetheless be entitled to indemnification even if there had been no antecedent request to undertake the suretyship.[88]

However, in *Owen* v. *Tate*,[89] Stephenson L.J. sought to confine Greene L.J.'s statement to cases of payment under necessity.[90] In that case, the defendants had borrowed from a bank on security granted by a third party. In order to procure the release of the security, to benefit the third party, the plaintiff deposited new security with the bank and guaranteed the loan. When the defendants learnt of the plaintiff's action, they protested, but on demand by the bank, they instructed the bank to have recourse to the security lodged by the plaintiff. The bank did so. The plaintiff claimed reimbursement from the defendants. His claim failed, the court categorising him as a volunteer who was not entitled to relief. It is to be noted that the third party, who had been released by the plaintiff's lodgement of security, would have been entitled to reimbursement from the defendants, had she paid without having been released. The question therefore was whether the plaintiff, who had undertaken his liability in order to release the third party, could have any similar right as against the principal debtor.

Scarman L.J. considered that a voluntary payer of another's debt had no right to reimbursement by the debtor. There were exceptions where "the law could imply a request."[91] In the present case, the plaintiff had "officiously expose[d] himself to the liability to make the payment."[92] Scarman L.J. stated that in a case where the plaintiff had "conferred a benefit upon the defendant behind his back in circumstances in which the beneficiary has no option but to accept the benefit, it is highly likely that the courts will say that there is no right of indemnity or reimbursement."[93] The present plaintiff, despite

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[85] (1834) 3 Mylne & K. 183, 190. See also *In re Moseley Green Coal & Coke Co. Ltd., Barrett's Case (No. 2)* (1864) 4 De G., J. & S. 756.
[86] *In re A Debtor (No. 627 of 1936)* [1937] 1 Ch. 156.
[87] [1937] 1 Ch. 156, 166, referring to *Brook's Wharf and Bull Wharf, Ltd.* v. *Goodman Brothers* [1937] 1 K.B. 534.
[88] Also note *Anson* v. *Anson* [1953] 1 Q.B. 636, 642-3 *per* Pearson J.
[89] [1976] 1 Q.B. 402.
[90] As to necessity, see section 4.5, *post.*
[91] [1976] 1 Q.B. 402, 407.
[92] [1976] 1 Q.B. 402, 407, quoting Goff and Jones, *op. cit.* (1st ed., 1966), 207.
[93] [1976] 1 Q.B. 402, 409.

having intervened for the benefit of the third party, was "as absolute a volunteer as one could conceivably imagine anyone to be when assuming an obligation for the debt of another."[94]

The defendants had pressed the bank to realise its claim from the security deposited by the plaintiff, and the bank had done so. The plaintiff argued, plausibly one might have thought, that by so doing, the defendants had accepted the benefit of the guarantee, and with it, the reciprocal obligation to reimburse the plaintiff. The Court of Appeal did not take this view. Instead, Scarman L.J. stated that the defendants had made the best of the situation in which they found themselves, where their indebtedness was secured in a manner to which they had not assented. With respect, this seems to be too beneficent a view to take of the defendants' conduct: since they had urged the bank to realise the security given by the plaintiff, they should not have been allowed to escape liability to either the bank or the plaintiff for that amount.[95] They should not have been allowed to take the benefit without the co-ordinate burden.[96] The members of the court did appear to envisage that there might be some circumstances where a surety who undertook his liability without an antecedent request from the principal debtor might be entitled to relief.[97]

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[94] [1976] 1 Q.B. 402, 410.

[95] Goff and Jones, *op. cit.* (5th ed., 1998), 129 and 446, are of the view that the plaintiff should have been subrogated to the bank's rights, as otherwise, it seems that the bank could (at least in theory) have made a double recovery, and thus been unjustly enriched. On Mitchell's scheme, this would be a case of "simple subrogation," as in the case of insurers: Mitchell, *op. cit.*, 166. A. Burrows, *The Law of Restitution* (1993), 83, 215, suggests that the plaintiff should have been entitled to subrogation under section 5 of the Mercantile Law Amendment Act 1856 (which was not raised), as the plaintiff was liable with another for the payment of the debt. That Act has been repealed in Ireland, subject to certain reservations, as to which, see section 7.7, *post.* Watts, "Guarantees undertaken without the request of the debtor," [1989] L.M.C.L.Q. 7, 9, thinks that a term can be implied into almost any guarantee, that the surety expects to be subrogated to the creditor's rights against the principal debtor upon payment. Watts does observe (at 10) that, if subrogation exists merely to prevent an unjust enrichment, then it is hard to see how subrogation could in principle have been available to the surety if he had been denied a personal right to indemnification on restitutionary grounds. Mitchell, *op. cit.*, 166-7, also argues that if the surety was rightly refused indemnification, he should have no alternative right to subrogation. However, he thinks that the surety in *Owen* v. *Tate* should not have been characterised as a volunteer. He also agrees with Burrows that section 5 did not appear to discriminate between voluntary sureties and "requested" sureties.

[96] One makes this statement conscious of the admonition of Ormrod L.J. (at [1976] 1 Q.B. 402, 413): "looked at superficially this case could be said to be one in which the defendants had acquired a considerable benefit from the acts of the plaintiff and had given nothing in return." However, he said that the sequence of transactions was so complex that he was unable to say whether the defendants in fact obtained any benefit from the plaintiff's actions, or whether the defendants' position was not worsened by the plaintiff's intervention.

[97] *Cf.* J. Phillips and J. O'Donovan, *The Modern Contract of Guarantee* (2nd ed., 1992), 502, who describe *Owen* v. *Tate* as a case where the defendants "ultimately accepted the benefit of the plaintiff's actions but initially they neither requested nor wanted this benefit." They conclude that "the mere fact that the guarantor's payment confers a benefit upon the debtor does not ensure the success of his restitutionary claim for reimbursement where the benefit was unwanted or unnecessary." After *Owen* v. *Tate*, in *The Zuhal K and the Selin* [1987] 1 Lloyd's Rep. 151, Sheen J. envisaged that a party which gave a guarantee in circumstance of "economic necessity" for the benefit of the principal debtor should be entitled to indemnification from the principal. The creditor had arrested the principal's ship. The principal's protection and indemnity club requested the surety to guarantee the payment of the debt, and this was done. The ship was released as a result of the granting of the guarantee. In the circumstances, the giving of the guarantee was not regarded as a gratuitous intervention. It is felt that this reflects a commercially

3.8.b Case of Voluntary Payment by one who is bound as Surety

Where a surety pays a debt which the creditor could not have recovered from the principal, it seems that his payment will be regarded as voluntary, and he will not be entitled to recover a similar sum from the principal.[98] The English and Irish cases concern situations where neither principal nor surety could have been compelled to pay, and yet the surety pays, and is then denied an indemnity from the principal. So, in *Sleigh* v. *Sleigh*,[99] an accommodation indorser (surety) of a bill of exchange paid the holder (creditor) without receiving notice of dishonour or any request for payment from the acceptor (principal debtor). It was held that the indorser could not recover from the acceptor, as he had paid knowing that he was not bound to do so, and had had no implied authority from the acceptor to make the payment. The court indicated that the result might have been different if the surety had paid in ignorance of a factor which would have relieved him from liability to pay (for instance, the giving of time by the creditor to the principal). In *In re Morris; Coneys* v. *Morris*,[100] it was held that a surety who paid a debt which was statute-barred as against him and the principal, could not recover that amount from the principal. On the other hand, it has been held that if a surety elects to waive the benefit of a condition which was inserted into the contract of guarantee for his own benefit, a subsequent payment by him in settlement of the creditor's claim will not be regarded as voluntary.[101]

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realistic and desirable approach to the issue. One may also note R.M. Goode, *Legal Problems of Credit and Security* (2nd ed., 1988), 190-1, who expressed the view that a surety who became bound without request from the principal debtor was entitled to subrogation. No reference is made to any authority for this proposition.

[98] See A.A. Stearns, *The Law of Suretyship* (5th ed., 1951, by J.L. Elder), § 11.41, and note 75, referring to *Davis* v. *Board of Commissioners of Stokes County*, 72 N.C. 441 (1875): "There is no doubt of the rule, that the principal is responsible to the surety for any liability incurred by the surety at the request of the principal. But that rule is subject to exceptions. A surety for an idiot, infant, feme covert, etc., may be liable when the principals are not liable either to the obligee or to him. So a surety for a corporation in a transaction where the corporation has not the power to contract, may be liable when the corporation is not." In *McHenry* v. *Carson*, 41 Ohio St. 212, 222 (1884), Dickman J. said "The surety cannot, by a voluntary payment, when not legally bound, place himself in a better position towards the principal, than that of one not a surety, who voluntarily pays money in the discharge of the debt of another person" (followed in *Mutual Finance Co.* v. *Politzer*, 21 Ohio St. 2d 177, 185; 256 N.E. 2d 606, 612 (1970)).

[99] (1850) 5 Ex. 514.

[100] [1922] 1 I.R. 81, 90, 136. The case is noteworthy as a rare decision of the High Court of Appeal of Ireland, established under the Government of Ireland Act 1920.

[101] *Stimpson* v. *Smith* [1999] 2 W.L.R. 1292. In that case, a surety paid the creditor before the latter made a formal demand for payment, which was required under the contract of guarantee before the creditor could recover from the surety. The Court of Appeal of England and Wales held that the requirement for a written demand was only evidential or procedural, and was not a prerequisite for the liability of the surety. The surety was entitled to waive the requirement, even as against a co-surety. It was therefore held that the paying surety was entitled to recover a contribution from his co-surety, in circumstances where the creditor would have served the written demand had the payment not been made. The court did note that a payment by one co-surety without the prior consent of the other co-surety, or a court order requiring that

Where the surety has a defence, but the principal does not (for instance, that the creditor had given time to the principal, thereby discharging the surety), it seems that in America at least, the surety will be entitled to indemnification from the principal.[102] The principal was undoubtedly bound to pay the creditor, and the surety should not be condemned as a volunteer for electing to abide by his undertaking, and waiving a defence. This seems to be quite a proper result, although it is possible that Irish or English courts would take a different view.[103]

3.8.c Payments by Insurer

It seems generally to be accepted that an insurer does not act voluntarily where he pays a claim which is doubtful or disputable, so long as he does so "in good faith."[104] Again, if the insurer believes himself to be liable to pay, even if he does so under a mistake of law, or if he has a personal interest in making the payment, it seems that it will not be regarded as voluntary.[105]

Mitchell cannot claim that the "unjust factor" is legal compulsion in such a case, since the premise is that the insurer was under no legal liability. However, he states that the unjust factor justifying subrogation may be mistake. Even if the mistake is not regarded as sufficient to justify a remedy, he says that there exists a general policy to encourage insurers to pay insureds even though they are not strictly bound to do so.[106] Quinn,[107] however, argues that Mitchell has stated this supposed policy in over-broad terms and asserts that there is a countervailing policy weighing against the payment of fraudulent claims, and favouring the prudent review of claims.[108] At the same time, he regards the supposed prohibition on the subrogation of volunteers as being weak in the insurance context in the United States. Mitchell's view gains support from a recent American decision,[109] where the court stated that the liberal availability of subrogation in cases where liability was uncertain encouraged the early settling of claims, in the interests of policy-holders.

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other co-surety to pay left it open to the latter to claim that the payment was voluntary. However, on the facts of the case, no such argument could succeed.

[102] Stearns, *op. cit.*, § 11.42.

[103] As an extension of *Sleigh* v. *Sleigh* (1850) 5 Ex. 514, *In re Morris; Coneys* v. *Morris* [1922] 1 I.R. 81, 90, 136 and *Owen* v. *Tate* [1976] 1 Q.B. 402.

[104] *King* v. *Victoria Insurance Co. Ltd.* [1896] A.C. 250; *Northland Insurance Co.* v. *Ace Doran Hauling & Rigging Co.*, 415 N.W. 2d 35 (Minn. App. 1987); *Weir* v. *Federal Insurance Co.*, 811 F. 2d 1387 (C.A., 10 Colo. 1987)

[105] *Weir* v. *Federal Insurance Co.*, 811 F. 2d 1387 (C.A., 10 Colo. 1987); *Auto Club Insurance Association* v. *New York Life Insurance Co.*, 485 N.W. 2d 695, 698 (Mich. 1992).

[106] Mitchell, *op. cit.*, 105, 106. Also, Mitchell, "Defences to an Insurer's Subrogated Action," [1996] L.M.C.L.Q. 343, 355.

[107] "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1380-1383.

[108] *Op. cit.*, at 1381.

[109] *State Farm Mutual Automobile Insurance Co.* v. *Northwestern National Insurance Co.*, 912 P. 2d 983 (1996, Utah); [1997] Rest. L. Rev. § 256, note by Kull.

3.8.d Payments intended as a Gift

If a payment of another's debt, or of a debt for which the payer and another were bound was intended as a gift, the payer will not be subrogated to the creditor's rights.[110] It seems that the payment will not be regarded as discharging the indebtedness of the debtor, who will thus remain liable to the creditor.[111] However, if a payer made a payment in order to protect property in which he had an interest, this will normally outweigh any inference of a donative intention.[112]

3.9 Whether Subrogation takes place by payment *ipso facto*, or whether some form of perfection is necessary

At one point, Birks compares a payer's right of subrogation to a constructive trust of the creditor's rights against the debtor.[113] There is some authority for this view in the case of insurers.[114] Although this seems to envisage that a right of action was not automatically transferred without act by the creditor, Birks also compares the right of subrogation to an assignment by "operation of law," which suggests the opposite.[115]

In the United States, it has been stated that where a payer is subrogated, an assignment by the creditor whom he paid adds nothing to the payer's rights against a person who is primarily liable.[116] This

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[110] *In re Bugos*, 760 F. 2d 731; 86 A.L.R. Fed. 877 (C.A. 7th Ill., 1984).
[111] *In re Rowe, ex parte Derenburg & Co.* [1904] 2 K.B. 483; *Smith* v. *Cox* [1940] 2 K.B. 558.
[112] *Ibid.*
[113] Birks, *An Introduction to the Law of Restitution* (1985, rev. ed. 1989), 94. *Cf.* Marasinghe, "An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine," (1976) 10 Valparaiso U.L. Rev. 45, 275, 299: "It is the belief of this writer that subrogation is one of the remedial aspects of the constructive trust." He states that he hopes to demonstrate this in a later article. The present writer has not been able to locate any such article.
[114] *Hart* v. *Western Rail Road Corporation*, 13 Metcalf 99, 105-6 (Mass. 1848); *Phoenix Insurance Company of Brooklyn* v. *Erie and Western Transportation Company*, 117 U.S. 312; 29 L. Ed. 873, 878; 6 S. Ct. 750 (1886). *Cf. Commercial Union Assurance Co.* v. *Lister* (1874) L.R. 9 Ch. 483, 486 *per* James L.J., declining to describe the insured as a trustee of his cause of action "in such a way that he is to be deprived of his own free action" on an interlocutory application. The cases are examined by Derham, *op. cit.*, 23-5. There are many more cases which state that an insured holds moneys which he receives from a third party beyond that which is necessary to reimburse his uninsured loss on trust for the insurer: *e.g.*, *In re Casey, A Bankrupt*, unreported, the High Court, Hamilton P., 1st March, 1993, Bankruptcy No. 1799. See further, *post*.
[115] *Loc. cit.*
[116] (1974) 73 Am. Jur. 2d 670, § 111; *Fleming* v. *Beaver*, 2 Rawle 128, 132; 19 Am. Dec. 629, 631 (Pa. 1828) *per* Gibson C.J.:

> "an actual assignment is unnecessary. The right of substitution is everything, and actual substitution nothing. By a fiction, to which we are indebted for nearly all our equitable jurisdiction, the law has made the assignment already."

does not appear always to be correct, however, as if a payer procures an assignment of a right of action, he may generally enforce it as if he were the original creditor, whereas if he claims as having been subrogated to the creditor's rights, his recovery is normally limited to the amount which he has paid.[117]

As regards the insurer, it appears that he needs the consent of the insured in order to bring an action in his name (though this consent may be given in the policy): thus, it cannot be said that the insurer's right of subrogation is complete upon payment to the insured. Thus, in *The "Aiolas,"*[118] Oliver L.J. stated that "[t]he right of subrogation entitles the insurer to call upon the insured to permit his name to be used in a suit for the benefit of the insurer, but it does not vest the cause of action in him."[119]

There are some difficulties with the description of an insured as a trustee for the insurer. For one thing, the insured is under no positive duty to exercise his rights against the third party,[120] whereas a trustee would be expected to realise trust property expeditiously.[121] Also, where the insured has been fully indemnified for his loss, the insurer is said to have control over the action against the third party.[122] Ordinarily, a beneficiary of a trust does not exercise control over the administration of the trust.[123]

There is also some very scattered authority in favour of the proposition that a creditor holds his securities on trust for the surety after payment by the surety.[124] In *Mara* v. *Ryan*,[125] the Irish Court of Exchequer held that a surety was entitled to stand in the place of a judgment creditor as against the estate

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See also *Robinson* v. *Leavitt*, 7 N.H. 73, 99 (1834); *In re Ted True, Inc.* 94 B.R. 423, 427 (Bkrtcy. N.D. Tex. 1988): "Where a right to subrogation exists, the general rule is an assignment adds nothing to the right; recovery is by virtue of a right in equity, not by virtue of a legal right under an assignment." Compare, however, Sheldon, *op. cit.*, § 45:

> "The right of subrogation to the benefit of a prior incumbrance is sometimes enforced by compelling an assignment of the prior lien to the party entitled to be subrogated thereto ... The right to demand an assignment is now generally limited to cases in which the party who is entitled to redeem, and thereupon to be subrogated to the benefit of the lien from which he redeems, is also in effect a surety, or is in equity to be regarded as a surety, for the payment of the debt secured thereby." (Citations omitted).

[117] See *ante*. But *cf. Hill* v. *Brown* (1844) 6 Ir. Eq. R. 403, where it was held that an assignee of a mortgage which had been paid off for less than the amount due on it could only enforce it for the amount paid.
[118] [1983] 2 Lloyd's Rep. 25.
[119] [1983] 2 Lloyd's Rep. 25, 30.
[120] *Andrews* v. *Patriotic Assurance Company of Ireland (No. 2)* (1886) 18 L.R. Ir. 355, 372.
[121] Derham, *op. cit.*, 23.
[122] *Commercial Union Assurance Co.* v. *Lister* (1874) L.R. 9 Ch. 483; Derham, *op. cit.*, 24.
[123] Derham, *loc. cit.*
[124] *Ex parte Rushforth* (1805) 10 Ves. 409, where it was held that a creditor who had presented a proof in the bankruptcy of the principal, and had then been paid by a surety the entire of the amount which the surety guaranteed, held his proof and any dividends received thereon in trust for the paying surety (following *Ex parte Wood* (1791), Lord Thurlow L.C., cited in *Ex parte Rushforth* (1805) 10 Ves. 409, 420).

of the principal debtor. They stated that the property should be sold, with the creditor retaining the judgment for the time being as trustee for the surety.[126] In *China and South Sea Bank Ltd.* v. *Tan*,[127] Lord Templeman said on behalf of the Privy Council (*obiter*) in a case where a creditor held a mortgage over the principal debtor's property:

> "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 of the mortgaged securities to procure recovery of the whole or part of the sum he has paid to the creditor."[128]

However, as in the case of the insurer, a creditor in general owes no positive duty to a surety to pursue his rights against the principal debtor or realise security held for the debt.[129] It may be more correct as a general proposition to say that the payer has an equitable lien on the creditor's right of action prior to payment by him.[130] After payment, the issue arises whether that right of action automatically vests in the payer.

As regards the surety, the position is confusing.[131] Under Roman law, it seems clear that the surety did not have the benefit of "automatic subrogation." If he paid the creditor, and failed to obtain a

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[125] (1838) 2 Jones 715.

[126] Note also *Scott* v. *Knox* (1838) 2 Jones 778, 781, where counsel for the surety argued that once the surety had paid the creditor, the latter became a trustee of a mortgage which he held against the principal debtor, for the benefit of the surety. The court did not refer to this specific assertion. Goff and Jones, *op. cit.*, 446, state that if the holder of a bill of exchange receives part payment from an indorser and then recovers the full amount of the bill from the acceptor, he holds an amount equal to that paid by the indorser on trust for the indorser (citing *Jones* v. *Broadhurst* (1850) 9 C.B. 173).

[127] [1990] 1 A.C. 536.

[128] [1990] 1 A.C. 536, 545. See also *Ulster Bank* v. *Lambe* [1966] N.I. 161, 169 *per* Lowry J.

[129] *Baker* v. *Briggs*, 8 Pickering 122; 19 Am. Dec. 311, 317 (Mass. 1829); *Lindsay* v. *Lord Downes* (1840) 2 Ir. Eq. R. 307, 312; *Belfast Banking Company* v. *Stanley* (1867) 1 I.L.T.S.J. 246; 15 W.R. 989 (ten years delay in claiming against the principal debtor no discharge to surety); *McKecknie* v. *Ward*, 58 N.Y. 541, 547; 17 Am. Rep. 281 (1874) *per* Folger J.; *O'Connor* v. *Sorohan* [1933] I.R. 591, 605 *per* FitzGibbon J. Similarly, an agreement to extend time for payment by the principal debtor has no effect on the surety's liability unless the agreement is binding: *Philpot* v. *Briant* (1828) 4 Bing. 717; *Whitehill* v. *Wilson*, 3 Penrose & Watts 405; 24 Am. Dec. 326, 328 (Pa. 1832) *per* Gibson C.J.; *United States* v. *Simpson*, 3 Penrose & Watts 437; 24 Am. Dec. 331, 333 (Pa. 1832) *per* Gibson C.J.; *Bank of Montpelier* v. *Dixon*, 4 Vt. 487; 24 Am. Dec. 640 (1832); *Cooper* v. *North* (1836) 2 Jones 210, 213; *Bangs* v. *Strong*, 10 Paige Ch. 11 (N.Y. 1842); *Vilas* v. *Jones*, 10 Paige Ch. 76, 79 (N.Y. 1843) *per* Walworth C.; *Baker's Executors* v. *Marshall*, 16 Vt. 522; 42 Am. Dec. 528 (1844); *Madden* v. *McMullen* (1860) 6 L.T. 180; 6 Ir. Jur. (n.s.) 15; *Pittsburg, Fort Wayne and Chicago Railway Co.* v. *Shaeffer*, 59 Pa. 350, 356 (1869); *Clark* v. *Sickler*, 64 N.Y. 231; 21 Am. Rep. 606, 607 (1876); *R.* v. *Fay* (1879) 4 L.R. Ir. 606.

[130] The House of Lords left this question open in *Napier* v. *Hunter* [1993] A.C. 713. This answer seems to be consistent with judicial statements to the effect that an insurer's right of subrogation vests at the time of execution of the contract of insurance: *Boag* v. *Standard Marine Insurance Co.* [1937] 2 K.B. 113, 122, where the right was described as a contingent one. Goff and Jones, *op. cit.*, 139, note 67, assert that the right does not vest in the insurer until it has paid the insured.

[131] For detailed discussion, see section 7.8, *post.*

cession or assignment of the creditor's securities, they would be deemed to have been extinguished.[132] However, he was entitled to withhold payment if the creditor refused to execute the cession. This right constituted a potential defence to an action by the creditor for payment.[133] However, he could not avail of the creditor's rights against the principal debtor or co-sureties in the absence of an actual cession.

Prior to the Mercantile Law Amendment Act 1856,[134] it seems that the surety did require an assignment, and that if a security was discharged by his payment, he could claim no rights in respect of it.[135] The Act provided that the surety might enforce any security held by the creditor against the principal debtor or a co-surety. There was, however, a difference of opinion as to whether the surety still required an express assignment of the security (to which he would undoubtedly be entitled) before he could enforce it against the principal or co-surety,[136] or whether he could enforce it upon payment, without the need for an express assignment.[137] Since the repeal of the Act in Ireland,[138] matters are still less clear. However, the saving provision in the repealing Act purports to preserve all equitable rights arising out of any provision thereby repealed, so the better view may be that the surety may regard himself as substituted *ipso facto* to the rights of the creditor, without the need for an express assignment.[139] It need hardly be said that an assignment may render the path of enforcement easier to him.

As regards lenders, the majority of the cases concern a situation where the lender has had no assignment. Under the Roman law, there could be no subrogation of a stranger unless he contracted for it with the debtor.[140] However, if contracted for, the effect of the contract was that the lender or payer succeeded to the place of the former creditor, without, it seems, the need for a formal cession.[141] Under most common law systems, it appears that the courts, upon a finding that the lender had been subrogated, merely declare him entitled to the benefit of a security, rather than directing its transfer to the lender.[142] As

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[132] Dixon, *op. cit.*, 43-6, 63.
[133] D. 46.6.12 (Papinian); Dixon, *op. cit.*, 9; Zimmermann, *op. cit.*, 36-7. It was known as the "*exceptio cedendarum actionum.*" See *Hayes* v. *Ward*, 4 Johns. Ch. 123, 129-130 (N.Y. 1819).
[134] 19 & 20 Vict., c. 97, section 5.
[135] See, *e.g.*, *Rotherham* v. *Flynn* (1816) Beatty 555; *Bowker* v. *Bull* (1850) 1 Sim. (n.s.) 29, 34 *per* Lord Cranworth V.-C.
[136] *Kennedy* v. *Campbell* [1899] 1 I.R. 59; Dixon, *op. cit.*, 50 *et seq.*
[137] In favour of this theory: *Silk* v. *Eyre* (1875) I.R. 9 Eq. 393; *In re McMyn; Lightbown* v. *McMyn* (1886) 33 Ch. D. 575, 578. The matter is considered in more detail, section 7.8, *post.*
[138] Statute Law Revision Act 1983, section 1 and First Schedule, Part IV.
[139] See section 7.8, *post.*
[140] Dixon, *op. cit.*, 11.
[141] Dixon, *op. cit.*, 12.
[142] But note Halsbury, *The Laws of England* (4th ed., 1982), XVI, 793, to the effect that there is no automatic "right" of subrogation. In *Rogers* v. *Resi-Statewide Corporation Ltd.* (1991) 105 A.L.R. 145, it was held that a mortgagee whose mortgage was void, having been procured with a forged signature of one of the joint tenant co-mortgagors, had been subrogated to the rights of a prior mortgagee, whose valid mortgage had been paid off using the funds advanced by the defrauded mortgagee. It seems that Von Doussa J. ordered that the co-mortgagors should execute a new mortgage to the mortgagee to the amount

regards payers who have an existing interest in property over which they pay an incumbrance, the American position appears to be that the payer is *ipso facto* subrogated, and indeed is not entitled to an assignment.[143] Further, no judicial determination is necessary in order for a subrogated lender to enforce a right to which he has been subrogated.[144] The English cases (and some of the American ones) speak of one being deemed to keep an incumbrance alive for one's own benefit.[145] This appears to suggest that the payer's interest is recognised without an assignment. Those cases sometimes refer to the possibility of the payer having the incumbrance assigned to a trustee for his benefit. If he could do this, it is sometimes said, he should not be prejudiced for want of a formality.[146]

An early Irish case which assimilated the payer's position to that of a surety held that the purchaser of land subject to judgments was entitled to demand an assignment of the first judgment from the creditor as a condition of payment.[147] Lord Manners L.C. made the breathtakingly broad statement that the case could not be taken out of the "common rule of this Court, that when one person pays off the debt of another, he is entitled to an assignment of the security originally passed for the debt."[148] This shows that he thought that a surety or the payer of another's debt was entitled to an assignment. This appears to suggest that if the payer failed to take an assignment, he might have no rights against the person primarily liable.[149] Similarly, in *Johnson* v. *Zink*,[150] it was held that a mortgagor who had conveyed subject to the mortgage, but was compelled to pay the debt was subrogated to the mortgagee's rights under the mortgage against the land. In order to give effect to that right, he has was entitled to demand an

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of the old mortgage which had been discharged using the funds so advanced. See *Vassos* v. *State Bank of South Australia* [1993] 2 V.R. 316 *per* Hayne J. (cited from LEXIS transcript at *44).

[143] Sheldon, *op. cit.*, §§ 13 and 45; *Hubbard* v. *Ascutney Mill Dam Co.* 20 Vt. 402; 50 Am. Dec. 41, 43 (1848). See also *Robinson* v. *Leavitt*, 7 N.H. 73, 99 (1834); *Bell* v. *Woodward*, 34 N.H. 90 (1856).

[144] *G.E. Capital Mortgage Services* v. *Levenson*, 338 Md. 227; 657 A. 2d 1170 (1995); [1996] Rest. L. Rev. § 302, overruling 101 Md. App. 122; 643 A. 2d 505 (1994); [1995] Rest. L. Rev. § 286. In that case, a lender had advanced funds to pay off an existing mortgage, and obtained a mortgage in return. It foreclosed this mortgage, which it thought had priority. In fact, there had been an intervening mortgage, which still subsisted. It was held that it had been subrogated to the rights of the first mortgagee even though it had not known of the second mortgage until it had foreclosed its mortgage. The court held that the lender should be treated as having foreclosed the first mortgage, to which it had been subrogated, and not the mortgage which had been granted to it as lender.

[145] Thus, it is often said that, on payment by a person with an interest in property, an incumbrance will be deemed either to have been extinguished or kept alive, according to the presumed intent of the payer to do that which is most in his own interest, in the absence of actual evidence of his intent: *Thorne* v. *Cann* [1895] A.C. 11, 18-9 *per* Lord Macnaghten (in that case, the mortgage had actually been assigned to the purchaser, so the intention was not greatly in doubt); *Gibson* v. *Crehore*, 3 Pick. 475 (Mass. 1826); *Robinson* v. *Leavitt*, 7 N.H. 73, 99 (1834) *per* Parker J.; *Bell* v. *Woodward*, 34 N.H. 90 (1856); *Aiken* v. *Gale*, 37 N.H. 501 (1859); *Gannett* v. *Blodgett*, 39 N.H. 150, 153 (1859); *Hinds* v. *Ballou*, 44 N.H. 619 (1863); Sheldon, *op. cit.*, §§ 13, 28-37; *Ryer* v. *Gass*, 130 Mass. 227 (1881).

[146] *Robinson* v. *Leavitt*, 7 N.H. 73, 99 (1834).

[147] *Rotherham* v. *Flynn* (1816) Beatty 555.

[148] (1816) Beatty 555, 558.

[149] See also *Smithett* v. *Hesketh* (1890) 44 Ch. D. 161, 165, where North J. said that if a second incumbrancer paid off the first incumbrancer, she would be entitled to have the first incumbrance assigned to her.

assignment of the bond and mortgage for his benefit.[151] In another decision, it was said that the mortgagor's right to enforce the mortgage in his own name on paying the mortgagee in those circumstances was perfect without any assignment of the bond and mortgage.[152] If the mortgagee had refused to assign these, he might have been joined as a party to the suit, and compelled to do so. The mortgagee would have had to have borne the costs of this. This seems to mean that, as against the purchaser, who was in a position analogous to that of a principal debtor, the mortgagor's (surety's) right was complete, though as against subsequent incumbrancers without notice, an assignment might be necessary to enforce his right.

3.10 The Extent of the Substitution

An important question which sometimes gives rise to difficulties is whether a subrogated party succeeds to *all* the rights of the party who is paid. In the majority of cases, the answer given is "yes." In some contexts, the payer has not been held subrogated to all the rights of the creditor, on the belief that if he were, he would be improperly preferred to other claimants against the debtor. The proper result appears to depend on the category into which the payer falls.

As has been seen, Birks' theory is that subrogation is merely an unnecessary metaphor for a restitutionary remedy awarded where value which a claimant traces is applied in the discharge of a debt.[153] The difficulties associated with tracing have already been discussed. He argues that a claimant can only be held entitled to succeed to proprietary rights if he had an initial "proprietary base" in the money or property which came to the hands of the debtor and was used to discharge the debt.[154] If this were a general requirement, it would appear that it would be hard for a payer ever to establish a right to subrogation to a proprietary right.[155] In most cases, the effect of the initial payment will be to divest the

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[150] 51 N.Y. 333 (1873).

[151] Similarly, *Jumel* v. *Jumel*, 7 Paige Ch. 591, 595 (N.Y. 1839) *per* Walworth C.: "if the mortgagee refused to assign the mortgage to [the administratrix of the mortgagor's estate] upon being paid the amount [of the debt], he might have been compelled to do so, or compelled to resort to the mortgaged premises in the first instance."

[152] *McLean* v. *Towle*, 3 Sandf. Ch. 117 (N.Y. 1845).

[153] *Introduction to the Law of Restitution* (1985, rev. ed. 1989), 93.

[154] *Op. cit.*, 390.

[155] Mitchell, *The Law of Subrogation* (1994), who is generally well-disposed towards Birks' proprietary base theory, nonetheless notes (at 28) that this analysis does not explain all the cases. Birks (at 392-3) instances *Butler* v. *Rice* [1910] 2 Ch. 277 and *Brocklesby* v. *Temperance Building Society* [1895] A.C. 173 as cases which can only be explained on the proprietary base theory. In each case, the owner-debtor was unaware of the use of the money to pay the debt. Birks therefore concludes that the only justification for the results was that the payer had retained a proprietary interest in the money paid. However, it should be noted that the debtor's consent is not necessary for intention-based subrogation to occur: that of the creditor is sufficient. *Cf.* Dixon, *op. cit.*, 11, who states that a surety or co-debtor may obtain by subrogation with the assent of *either* debtor or creditor, and that an assignment from the latter may be enforced by decree if necessary. However, he states that where a stranger (such as a lender) claims subrogation, he must have the assent of the *debtor*. See also section 2.6, *ante*.

payer of any property in the money,[156] even where a contract under which the money was paid was void,[157] and hence, the payer's claim to subrogation to a proprietary right would be defeated immediately.[158] However, Birks then acknowledges that the case law establishes a far broader entitlement to subrogation to proprietary rights. Where a payer pays a secured creditor, or pays money to the debtor, on condition that it be applied to the payment of an incumbrance, Birks acknowledges that there is a presumption that the payer intended to obtain the benefit of the creditor's security.[159]

If one proceeds on a restitutionary theory, even without adopting the proprietary base theory, the question of when a proprietary remedy should be imposed is a difficult one. At one time, Goff and Jones argued that a proprietary remedy could be imposed whenever it seemed just and equitable.[160] They then modified their position, arguing that a proprietary remedy could be imposed if a payer had retained legal or equitable title, or if the recipient of the enrichment knew of the facts giving rise to the payer's claim. They also stated that the solvency of the recipient was a material factor.[161] In the latest edition of their work, they have effectively repudiated their earlier views, in light of the decision in *Westdeutsche Landesbank Girozentrale*.[162]

Burrows advances a sensible argument to the effect that where a payer paid on the understanding that he was to receive security, and this does not occur, he will be subrogated to the proprietary rights of the creditor as the closest approximation equity can give to performance of the original agreement.[163] If one uses a restitutionary analysis, it is felt that Burrows' theory is the most accurate one.

Mestre's argument is that subrogation to proprietary rights should be widely permitted, because it encourages third parties to discharge debts of others where either the current creditor or debtor wished it. The fact that the payer was subrogated to proprietary rights was the "*raison d'être*" of subrogation.[164] The creditor's prospects of being paid were increased, and the debtor had an increased opportunity to re-finance his debts or obtain a more favourable creditor.[165]

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[156] See, *e.g.*, *In re Goldcorp Exchange Ltd. (in receivership)* [1995] 1 A.C. 74.
[157] *Cf. Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669.
[158] *Cf.* Birks, *op. cit.*, 391-2.
[159] Birks, *loc. cit.* He refers to *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732, 745 and *Wylie* v. *Carlyon* [1922] 1 Ch. 51.
[160] *Op. cit.*, (3rd ed., 1986), 78.
[161] *Op. cit.*, (4th ed., 1993), 93-102.
[162] *Op. cit.*, (5th ed., 1998), 89-91, referring to *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669.
[163] *The Law of Restitution* (1993), 85-7, 89-90. Mitchell does not seem hostile to this analysis: *op. cit.*, 34.
[164] Mestre, *La Subrogation Personnelle* (1979), § 28.
[165] *Op. cit.*, § 29.

However, where a payer intended an unsecured loan, he will not be held to have been subrogated to the proprietary rights of a prior creditor.[166] Pothier stated that where one creditor was subrogated to the rights of another creditor, "the rights of the old creditor do not always pass to the new in the way that they were, but as modified, and converted into the nature of the claim which results from the contract reached between the new creditor and the debtor..."[167] An example of this rule is provided by *Rogers* v. *Resi-Statewide Corporation Ltd.*,[168] where it was held that a lender under a void mortgage who had been subrogated to the rights of prior mortgagees was entitled to recover interest at the rate reserved in his own void mortgage or at the rate reserved by the earlier discharged mortgages, *whichever was the lower.*[169]

In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[170] the plaintiff had lent funds to the use of the defendant, in order to pay off a first secured creditor. The plaintiff did not contract to obtain security. However, the general manager of the controlling company of the group of companies of which the defendant was a member wrote to the plaintiff, stating that each of the companies in the group agreed to subordinate its claims against the defendant to the claim of the plaintiff. This letter was unenforceable against the defendant, or O.O.L., a sister company of the defendant, and the second secured creditor. Lord Steyn held that the plaintiff was entitled to a personal restitutionary remedy against O.O.L., rather than subrogation to the proprietary rights of the prior creditor as against all the world. However, Lord Steyn said that he felt that the plaintiff was entitled to a similar remedy by means of subrogation. This would not be subrogation to the rights of the first secured creditor *in toto*. Rather,

> "The purpose of the relief would be dictated by the particular form of security, involving rights in personam against companies in the group, which [the plaintiff] mistakenly thought it was obtaining."[171]

Lord Hoffmann, with whom a majority of the House agreed, expressly decided the case on the second of these grounds, namely on a relativistic form of subrogation. On the basis that subrogation was

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[166] *Paul* v. *Speirway Ltd. (in liq.)* [1976] Ch. 220, 232 *per* Oliver J.; *Halifax Mortgage Services Ltd.* v. *Muirhead* (1997) 76 P. & C.R. 418, 426 *per* Evans L.J.; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 746-7 *per* Lord Hoffmann. In *In re Wrexham, Mold & Connah's Quay Railway Co.* [1898] 2 Ch. 663, reheard [1899] 1 Ch. 205, affirmed [1899] 1 Ch. 440, a payer under a contract for advances which *it* claimed was invalid was held not entitled to subrogation to the secured rights of creditors whom it had paid. Although the decision is unexceptionable, there were certain *dicta* to the effect that there could never be subrogation to a proprietary right, which is clearly erroneous.

[167] M. Pothier, *Coutumes des Duché, Baillige et Prévoté d'Orléans, et ressorts d'iceux*, in Dupin (ed.), *Oeuvres de Pothier*, X (1827), n° 85. *Cf. Halifax Mortgage Services Ltd.* v. *Muirhead* (1997) 76 P. & C.R. 418, 426 *per* Evans L.J.: "... the extent to which [the rights transferred] may be exercised by the third party ... depends also upon the terms on which the money, which is used to discharge the original mortgage, is advanced to the borrower by the new lender."

[168] (1991) 105 A.L.R. 145; 32 F.C.R. 344.

[169] To the same effect, *Chetwynd* v. *Allen* [1899] 1 Ch. 353.

[170] [1998] 1 All E.R. 737.

[171] [1998] 1 All E.R. 737, 741.

not an absolute right, but rather was a remedy to reverse an unjust enrichment (at least in the present context), he held that there was no reason why the lender had to be subrogated absolutely to all the rights of the creditor:

> "It does not by any means follow that the plaintiff must for all purposes be treated as an actual assignee of the benefit of the charge and, in particular, that he would be so treated in relation to someone who would not be unjustly enriched."[172]

There would only be an unjust enrichment if the plaintiff were granted no relief as against O.O.L. Therefore, the plaintiff should only be subrogated as against O.O.L. As far as any other parties were concerned, the plaintiff had no rights in security against the defendant company. The decision is a startlingly innovative one, and clearly evinces a desire to ignore the metaphor of "substitution": a remedy is awarded which is made to measure the extent of the unjust enrichment which would otherwise result. The approach is organic rather than formalistic.[173]

It seems, however, that outside of the limitations imposed by the payer's own contract with the debtor, a subrogated party will generally succeed to the creditor's rights *in toto*. In Ireland and England, an insurer who has been subrogated to the rights of its insured must enforce those rights in the name of the insured. The nominal plaintiff is therefore the insured, and the fiction is generally observed that the insured is the plaintiff, and in control of the litigation. Therefore, subject to certain exceptions, which are discussed at a later point, one would expect that, for the purposes of litigation, the insurer will be regarded as having exactly the same character as the insured. In certain other jurisdictions, however, where the insurer is required to proceed in his own name, courts may be loath to accept that the insurer is in exactly the position of the insured. In an American decision, a court held that an insurer could not be subrogated to its insured's right to claim punitive damages under a Deceptive Trade Practices Act.[174] The right to punitive damages only vested in "consumers," and the court effectively declined to hold that the insurer could avail of that status.[175]

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[172] [1998] 1 All E.R. 737, 749.

[173] See also Mitchell, "Subrogation, Unjust Enrichment and Remedial Flexibility," [1998] Rest. L. Rev. 144, 145; Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 233-9; Wright, "The Rise of Non-Consensual Subrogation," [1999] Conv. 113, 121.

[174] *Trimble* v. *I.T.Z.*, 898 S.W. 2d (Tex. App., San Antonio), writ denied, neither approving nor disapproving, 906 S.W. 2d 481 (Tex. 1995), cited by Quinn, *op. cit.*, at 1375, note 50.

[175] The Court of Justice of the European Union adopted a similar approach in a case which did not concern insurance, Case C-89/91, *Shearson Lehman Hutton* v. *T.V.B. Treuhandgesellschaft für Vermögensverwaltung und Beteiligungen m.b.H.* [1993] E.C.R. I-139, in which it held that a corporate body which had paid a debt owed to a consumer, and obtained an assignment of his rights of action from him, could not sue under Article 14 of the Brussels Convention (Convention on Jurisdiction and the Enforcement of Judgments done at Brussels on the 27th September 1968) in the state in which he was resident as a consumer. In effect, his right to sue in the place where he resided did not pass by the assignment.

A surety is in general entitled to a perfect substitution to the rights of the creditor whom he pays.[176] This right was codified by the repealed section 5 of the Mercantile Law Amendment Act 1856. Nonetheless, it is felt that, in view of the elaborate saver contained in the repealing statute, the breadth of the surety's right remains unrestricted. Mitchell's attempt to force the square peg of the surety's rights into the round hole of restitution leads him to criticise section 5 of the Mercantile Law Amendment Act 1856 which permitted the surety to avail of all securities held by the creditor over property of the principal debtor or co-sureties in order to reimburse himself. Mitchell's criticism is that there is no factor which justifies granting the surety a "proprietary remedy" against the principal debtor or co-surety in preference to the run of unsecured creditors.[177] However, if one regards the surety's right as arising as a consequence of his status, or, if one prefers, as an implied term arising out of the nature of his undertaking, then the objection loses its force. This is quite aside from the fact that, in England at least, the surety's right is consecrated by statute; so criticism of "proprietary overkill" must remain academic for the time being.

3.11 Whether the Subrogated Party may sue the Debtor in his own name

In Ireland and England, insurers who have been subrogated to the rights of the insured are bound to pursue a third party in the name of the insured.[178] The law is otherwise in France[179] and in many American jurisdictions.[180] In all common law jurisdictions, it seems to be the law that a surety or co-debtor may pursue a principal or co-debtor in his own name, though he may be entitled to use the name of the creditor, on offering him a proper indemnity.[181]

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[176] Subject to certain exceptions. See, *e.g.*, *In re Russell; Russell* v. *Shoolbred* (1885) 29 Ch. D. 254; see *post.* It appears that originally, it was accepted in America that a subrogated party was entitled to succeed to the priority of the creditor who had been paid, even in cases where the creditor was a state authority which enjoyed priority for claims it had in its own right: *American Oil Co.* v. *McMullin*, 508 F. 2d 1345 (10th Cir., 1975); *In re Missionary Baptist Foundation of America*, 667 F. 2d 1244 (5th Cir. 1982). However, where the primary debtor had become bankrupt, or had put his affairs under management of the court, the rule was later changed, to preclude a subrogated party from claiming the priority given to State claims: 11 U.S.C. § 507 (d); *In re Missionary Baptist Foundation of America* 667 F. 2d 1244 (5th Cir. 1982); *In re Ted True, Inc.*, 94 B.R. 423 (Bkrtcy. N.D. Tex. 1988) (payer of taxes for which another was primarily liable was not entitled under this provision to the State's priority in the bankruptcy of the person primarily liable); *In re Woerner*, 19 B.R. 708 (Bkrtcy. D. Kan. 1982) (surety who paid debtor's tax obligations not entitled to State's priority); *In re Alva Cooper*, 83 B.R. 544 (Bkrtcy. C.D. Ill. 1988) (a former spouse who paid the income tax for which the other party was liable under a divorce settlement was not entitled to the Inland Revenue Service's priority in the bankruptcy of the other party).

[177] *The Law of Subrogation* (1994), 59.

[178] See sections 10.1 *et seq.*, *post.*

[179] De Juglart and Chassériaux, (1952) 5 *Revue trimestrielle de droit commercial* 643, 644.

[180] Owing to rules of court requiring actions to be brought in the name of the "real party in interest": see Horn, *op. cit.*, 86-89.

3.12 The Law Governing Subrogation

The choice of the conflict of law rules applicable to a party's entitlement to subrogation may depend upon whether subrogation is regarded as a substantive right, possibly arising out of contract, or as a remedy. This is illustrated by the case of *In re Valley Vue Joint Venture*,[182] where a contract provided that it was subject to the law of Maryland. A claim to have been subrogated arose in a court applying the law of Virginia. Virginia law provided that questions relating to remedies were governed by the law of the forum. The court regarded subrogation as being an equitable remedy, and therefore applied the law of Virginia to decide whether or not the claimant was entitled to subrogation.

Subject to what has been said above, it is generally held that the law which governs the contract between principal and surety governs the rights of the surety upon payment. Thus, in *In re Alcon Demolition, Inc.*,[183] the contract between principal and surety was subject to the law of New Jersey, and the subrogation rights of the surety were governed by the law of that State.

The subrogation or other rights of recourse of an insurer are determined by the proper law of the contract. Where the insurer claims to have been subrogated to the right of action of its insured, its entitlement to subrogation is determined by the law of the contract. However, once it is decided that the insurer is entitled to subrogation, its right of action is derived from the insured, and is therefore governed by the same law which governed the insured's right of action. For example, if an insurance contract is entered into in England, the contract being governed by English law, then English law decides whether or not the insurer is subrogated, and on what conditions.[184] If the insured suffers a loss as a result of the wrong of a third party in France, then the insurer, if subrogated, must sue the third party in France according to French law. There may, however, be procedural complications. As will be seen, in Ireland and England and Wales, an insurer must sue in the name of its insured unless it has obtained a legal assignment of the insured's right of action. By contrast, many other jurisdictions *require* the insurer to sue in its own name. The law governing the insurance contract determines the circumstances in which the insurer may exercise his rights. Thus, in a French decision in 1970, a court permitted insurers to sue in France in the name of the insured, which would not be permitted in respect of domestic insurers, on the

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[181] Mercantile Law Amendment Act 1856, section 5; *Lindsay* v. *Lord Downes* (1840) 2 Ir. Eq. R. 307, 312 *per* Lord Plunket L.C.

[182] 123 B.R. 199, 204; 21 Bankr. Ct. Dec. 513; 13 U.C.C.R. Serv. 2d (Callaghan) 842 (Bkrtcy. E.D. Va. 1991).

[183] 204 B.R. 440, 446 (Bkrtcy. D. N.J. 1997).

[184] See, *e.g.*, *The "Astri Marie"* [1974] E.T.L. 118 (French Court of Appeal), noted [1974] L.M.C.L.Q. 205: an insurance contract was executed in England between an English insurer and insured. The damage occurred in England. The French courts would consult English law in order to establish the extent to which subrogation of insurers was permitted under English law, as, although it did not coincide with French law, English law did not run counter to the public interest in matters of private international law.

basis that the contract of marine insurance had been entered into in London, and that English law governed the insurance contract and the rights of the insurer.[185]

In *Gracechurch Container Line Ltd.* v. *S.p.A. Assicurazioni Generali*,[186] the Italian *Corte di Cassazione* held that the liability of a carrier to a *shipper* was contractual rather than tortious. Therefore, jurisdiction fell to be determined having regard to the rules for contract jurisdiction in Article 5 of the E.E.C. Judgments Convention 1968. There was also an interesting comment by the court that part of the claim by the plaintiff subrogated insurer, "for repayment of the indemnity paid to the insured company, plus revaluation and interest, 'on a contractual and / or non - contractual basis'" was irrelevant, because the legal classification of the action was a matter for the courts having jurisdiction, in this case those of England.

In some countries, social insurance institutions have either rights of subrogation or direct rights of action against third parties in respect of sums which they pay to accident victims. There is clearly no contract in such cases. The law governing the entitlement of those institutions to subrogation or other recourse is that of the jurisdiction in which they made the payments. Similar considerations should apply as in the case of private insurers under insurance contracts. While it is felt that this is the common law position, the law in relation to social insurance institutions of European Union member states has been put beyond doubt by Article 93 of E.E.C. Regulation 1408/1971.[187]

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[185] Cour de Paris, 17th October 1970, noted by de Juglart and du Pontavrice, (1971) 24 *Revue trimestrielle de droit commercial* 801-4.
[186] [1994] I.L.Pr. 206.
[187] *Van Keep* v. *Surface Dressing Contractors Ltd.*, unreported, the High Court, Budd J., 11th June, 1993, 1990 No. 694 P. (where the judge seems wrongly to have applied Irish law rather than Dutch law, the law of the social insurer in question); *Deutsche Angestellten-Krankenkasse (D.A.K.)* v. *Laererstandens Brandforsikring G/S* [1994] E.C.R. 2259; *Kahl* v. *Holderness Borough Council* [1995] P.I.Q.R. P 401.

PART II

PERSONS ENTITLED TO SUBROGATION:

IN GENERAL

CHAPTER 4

PAYERS OF ANOTHER'S DEBT

4.1 Payers of the debt of another

It seems to be generally accepted that if a stranger with no connection with a debt pays it off, without any request from the debtor, he does not thereby acquire any right to reimbursement from the debtor.[1] It seems that such a payment is not regarded as effective to discharge the debt.[2] As the debtor remains at least theoretically liable to the creditor, it is said that he has not obtained any benefit or enrichment, and therefore should not be liable in restitution to the payer.[3] There can certainly be no scope for recovery in contract if the payment was made without the request of the debtor.

If there is no underlying right to indemnification, one might expect that there could be no right to legal subrogation. There is a considerable body of *dicta* to the contrary, however. In one case, Lord Manners L.C. referred to the "common rule of this Court, that when one person pays off the debt of another, he is entitled to an assignment of the security originally passed for the debt."[4] In the later English case of *Newton* v. *Chorlton*,[5] Page Wood V.-C. said that the surety's right of subrogation to the creditor's rights in respect of securities granted *after* the surety had become such did not arise out of the original contract of suretyship: "It arises, I apprehend, from this, that the party who pays off any person who holds a mortgage or other security is entitled to have the benefit of all the securities that person so holds in respect of the debt which he has paid off: he has discharged the liability for which the security is held and,

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[1] In *Pownal* v. *Ferrand* (1827) 6 B. & C. 439, 443, Bayley J. said "The law is that a party by voluntarily paying the debt of another does not acquire any right of action against that other; but if I pay your debt because I am forced to do so, then I may recover the same, for the law raises a promise on the part of the person whose debt I pay to reimburse me." To similar effect were *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588, 601 (1837) *per* Tucker P. ("by our law no man has a right to pay another's debt, for which he is not bound, except in the case of a bill of exchange, by the law merchant"); *Homestead Co.* v. *Valley Railroad*, 17 Wall. (84 U.S.) 153, 167; 21 L. Ed. 622, 623 (1872); *Title Guarantee & Trust Co.* v. *Haven*, 196 N.Y. 487, 494; 89 N.E. 1082, 1084 (1909); *Newell* v. *Hadley*, 206 Mass. 335, 343; 92 N.E. 507, 511 (1910); *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 142, 115 N.E. 465, 466 (1917) *per* Chase J.: "One cannot make himself the creditor of another by the unsolicited payment of his debts."

[2] For a discussion of this, see *ante*.

[3] Birks and Beatson, "Unrequested Payment of Another's Debt," chapter 7 in J. Beatson (ed.), *The Use and Abuse of Unjust Enrichment* (1991), 177 at 190-1.

[4] *Rotherham* v. *Flynn* (1816) Beatty 555, 558.

[5] (1853) 10 Hare 646; 2 Drew. 333 (note). It should be noted that Page Wood V.-C.'s views as to the origin and nature of the surety's right to subsequently-acquired securities did not find favour in later cases: *Lake* v. *Brutton* (1856) 8 De G., M. & G. 440; *Campbell* v. *Rothwell* (1877) 47 L.J.Q.B. 144; *Forbes* v. *Jackson* (1882) 19 Ch. D. 615, 619-21; *Leicestershire Banking Co. Ltd.* v. *Hawkins* (1900) 16 T.L.R. 317. Page Wood V.-C. himself acknowledged this in *Pledge* v. *Buss* (1860) Johns. 663, 668.

and he is entitled to call for an assignment from that party of the securities he so holds."[6] There are numerous other judicial statements to the effect that a third party who pays off a mortgagee is thereby subrogated to the mortgagee's rights against the debtor. These statements do not qualify this entitlement by reference to any connection which the payer must have with the debtor or his property.[7] The most influential such comment was that of Lord Jenkins in *Ghana Commercial Bank* v. *Chandiram*:[8]

> "It is not open to doubt that where a third party pays off a mortgage, he is presumed, unless the contrary appears, to intend that the mortgage shall be kept alive for his own benefit."[9]

It will be seen that this statement is based on the *intention* of the payer. An Irish case where the court applied a similar presumption was *Walcott* v. *Condon*.[10] There, a payer paid off a first mortgagee, under a contract with the debtor by which the debtor agreed to grant the payer an annuity out of the same land. The first mortgagee transferred his mortgage to a trustee. The trustee and the debtor then granted an annuity to the payer. It was held that this annuity had priority over an intervening second mortgage. In this case, the payer had not contracted either with debtor or first mortgagee to obtain the benefit of the first mortgage. Nonetheless, the conveyance to a trustee showed that the parties had not intended to merge the first mortgage in the debtor's equity of redemption, and thereby let in the second mortgagee.[11]

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[6] (1853) 10 Hare 646, 656; 2 Drew. 333, 342 (note).

[7] *Attorney General* v. *Chitty* (1749) 1 D.B. Fowler, *The Practice of the Court of Exchequer upon Proceedings in Equity* (1795) 104; *Crosbie-Hill* v. *Sayer* [1908] 1 Ch. 866, 877 *per* Parker J.; *Butler* v. *Rice* [1910] 2 Ch. 277, 282 *per* Warrington J.; *Manks* v. *Whiteley* [1912] 1 Ch. 735, 743 *per* Cozens-Hardy M.R.; *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732, 745 *per* Lord Jenkins; *Cowcher* v. *Cowcher* [1972] 1 W.L.R. 425, 432; *Castle Phillips Finance* v. *Piddington* (1994) 70 P. & C.R. 592; *Rogers* v. *Resi-Statewide Corporation Ltd.* (1991) 105 A.L.R. 145; 32 F.C.R. 344, at para. 22 *per* Von Doussa J. (cited from LEXIS transcript); *Vassos* v. *State Bank of South Australia* [1993] 2 V.R. 316; 1992 VIC LEXIS 458, at *41; *Stronge* v. *Johnston*, unreported, Chancery Division, Northern Ireland, Girvan J., 16th April 1997, 1996 No. 1534 and *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 751 *per* Lord Hutton.

[8] [1960] A.C. 732.

[9] [1960] A.C. 732, 745. See also *Halifax Mortgage Services Ltd.* v. *Muirhead* (1997) 76 P. & C.R. 418, 425, where Evans L.J. quoted this passage with apparent approval, though it was conceded that subrogation had occurred in that case. He noted that there could be no actual intention, unless it was one conditional on the failure of the security which the payer had himself taken. He also adverted to the possibility that a right of subrogation arose because of the payer's mistake and the possible unjust enrichment of the borrower were subrogation not allowed.

[10] (1853) 3 Ir. Ch. R. 1.

[11] The case was distinguished from *Parry* v. *Wright* (1823) 1 Sim. & St. 369, affirmed (1828) 5 Russ. 142, where the purchaser of an equity of redemption borrowed a sum from the defendant, in order to pay off a mortgage on the land. The lender paid part of the money to the purchaser, and part to the mortgagee. The mortgagee conveyed the legal estate to a trustee for the purchaser under a deed which recited the purchase of the equity of redemption, and that the purchaser was desirous of paying off the mortgage. The next day, the trustee granted an annuity to the lender. It was held that the mortgage had been extinguished. In *Nelson* v. *McKee*, 99 N.E. 447 (Ind. 1912), the mortgagor requested the plaintiff to discharge a mortgage held by a third party. The plaintiff did so, and was granted a new mortgage at a lower rate of interest. Unknown to the plaintiff, an intervening judgment lien existed on the property. Rather strangely, the court held that the plaintiff could not claim to have been subrogated to the rights of the third party, because he

Other judges have expressed a far more restrictive view of the persons who are entitled on payment to an assignment of the payee's rights. In *Mara* v. *Ryan*,[12] Joy C.B. said that "no person was entitled to redeem [a mortgage], unless he were entitled to the equity of redemption... A third person cannot come in and redeem a mortgagee *in invitum*."[13] Pennefather B. said in the same case:

> "The mortgagee is not bound to assign the mortgage to a stranger; but if the person who requires the assignment be a surety for the principal debtor it is different."[14]

In the context of payments to finance the purchase of land, the majority of the Supreme Court also sounded a cautious note in *Munster and Leinster Bank* v. *McCann*.[15] In that case, the executor and trustee of the estate of his deceased brother paid the Land Commission a portion of the purchase price of lands out of his own moneys, in response, as he alleged, to a request from his deceased brother. He now claimed an equitable lien on the land on the basis that he had made a "salvage payment."[16] The Supreme Court held that he had no lien. Kennedy C.J. stated that the payer had not "saved" the estate. Prior to his payment, he had had neither interest in nor claim against the estate. FitzGibbon J. agreed, saying that it was "settled law that a stranger in interest acquires no lien" by an advance to purchase land. Murnaghan J. dissented, holding that the payment had been made on the understanding that the payer would obtain a first charge over the land to be bought.

The view expressed by the majority of the Supreme Court reflected a reluctance to allow a stranger to become a creditor of a person simply by paying a debt owed by that person.[17] One may compare the decision of the Supreme Court of Vermont in the well-known case of *Norton* v. *Haggett*.[18] The plaintiff in that case conducted investigations into the defendant's financial position, and then

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had acted voluntarily in paying. See Note, "Right of a 'Volunteer' to Subrogation as Against Intervening Incumbrancers," (1913) 13 Col. L. Rev. 58, In that case, the plaintiff had paid under a mistake, and should have been entitled to subrogation. See section 4.8.c, *post*.

[12] (1838) 2 Jones 715.

[13] (1838) 2 Jones 715, 717.

[14] (1838) 2 Jones 715, 718. See also *Flemington National Bank & Trust Co.* v. *Sindlinger*, 1 N.J. Super. 581; 62 A. 2d 498 (1948) (although a mortgagor, having an interest in the mortgaged property, was entitled to redeem, he was not entitled to an assignment of the mortgage unless he was a surety).

[15] [1937] Ir. Jur. Rep. 40.

[16] For the principle of salvage in equity, see *post*.

[17] Note the case of *In re Greendale Developments Ltd.; McQuaid* v. *Malone*, unreported, Laffoy J., 2nd July, 1997, noted Courtney (1997) Commercial Law Practitioner 237, where the first defendant was granted time to put in an affidavit stating the grounds on which she claimed, *inter alia*, to have been subrogated to the position of a secured creditor of the company, by paying a debt owed by the company to that creditor. The nature of the relations between the company and the first defendant prior to the alleged payment does not appear. The case was afterwards settled.

[18] 117 Vt. 130; 85 A.2d 571 (1952).

approached and paid off one of his creditors. The court held that he was not entitled to recover the amount which he had paid from the defendant, in the absence of an assignment of the creditor's claim.[19]

A number of English decisions also contain judicial statements to the effect that a mere stranger does not acquire an interest in a debtor's property nor become entitled to reimbursement from that debtor, merely because he pays a debt for which the debtor was liable.[20] In *In re Cleadon Trust Ltd.*,[21] a director paid debts of the company at the request of the secretary, who did not have the power to bind the company. A later resolution of the board of directors purporting to adopt the payments proved invalid. The director was refused any relief against the company on the ground that he had been a voluntary intervener.

Lord Jenkins in *Ghana Commercial Bank* based his comment on the intention of the payer, that he should become entitled to the mortgage held by the creditor whom he paid. This appears to be a defensible justification for holding subrogation to have taken place, *in cases where the creditor has accepted the payment as a discharge of the debt.* Thus, although the payer has no direct right of indemnification *vis-à-vis* the debtor, if the creditor accepts the benefit of the payment, he should not be permitted to deny that the payer is entitled to exercise his rights, if the payer so desires.[22]

4.2 Persons who make a payment at the Request of the Debtor

Many cases which are in substance ones of loan to a debtor or purchaser of property may take the form of a payment by the "lender" directly to the creditor or vendor. In these cases, the payer may claim to have been subrogated to the creditor or vendor's former rights. In *Boodle Hatfield & Co.* v. *British Films Ltd.*,[23] Nicholls J. held, on a consideration of an earlier case dealing with a loan to a purchaser,[24] that the payer would be deemed to have intended to be subrogated, unless there was a factor which

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[19] See also *Eastman* v. *Plumer*, 32 N.H. 238, 240 (1855) *per* Perley J.:

> "The holder of the note was not bound to assign it. He might insist that the note should be paid and discharged before he delivered it out of his hand" (contrasting the cases of payment by sureties and incumbrancers).

[20] *Hodgson* v. *Shaw* (1834) 3 Mylne & K. 183, 190 *per* Lord Brougham L.C. ("a person cannot make himself the creditor of another by volunteering to discharge his obligations"); *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234; *In re National Motor Mail Coach Co. Ltd.; Clinton's Case* [1908] 2 Ch. 515, 520 *per* Swinfen Eady J.: "If A voluntarily pays B's debt, B is under no obligation to repay A." This *dictum* was approved by Scarman L.J. in *Owen* v. *Tate* [1976] 1 Q.B. 402, 407.

[21] [1939] 1 Ch. 286.

[22] This argument has sometimes been applied to hold that a voluntary surety was subrogated to the creditor's rights against the principal, even though the surety had no right of indemnification from the principal: *Mathews* v. *Aikin*, 1 N.Y. 595, 602 (1848). On this issue, see *ante*.

[23] [1986] P.C.C. 176.

[24] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95.

displaced that presumption, for instance, an express term in the contract between payer and debtor or purchaser which was inconsistent with subrogation.[25] The Irish Supreme Court has approved of this statement, in a case of a loan to the purchaser for the purchase of the property.[26] On the other hand, Australian courts have adopted the opposite presumption, to the effect that subrogation should not occur unless it can be shown that there was either an express agreement to that effect, or an understanding between payer and debtor to that effect.[27]

In *Munster and Leinster Bank* v. *McCann*,[28] discussed in the last section, the dissenting judge, Murnaghan J., held that the payer who advanced funds to the vendor to enable the debtor to buy land was entitled to a first lien on the land in respect of the amount he had advanced, in priority to a mortgage granted by the debtor. Murnaghan J. seems to have thought that the debtor had agreed to grant a security, though there did not seem to be any evidence of this. He stated that

> "The accretion produced as the result of this sum [advanced by the payer] was acquired with money borrowed on the understanding that it was to be repaid in priority to existing charges. It is not equitable that the mortgagee should have the benefit of this payment and that the lender should lose his money so far as the security of the land is concerned."[29]

It will be seen that this conclusion is based on the intention of payer and debtor, as deduced by the judge. Since the intention would be frustrated if a lien were not granted, the judge felt that this should have been the outcome. He reached this conclusion without referring to the possibility of the subrogation of the payer to the vendor's lien. The case was argued as one of "salvage," a doctrine which is discussed in a later section.[30] The majority of the court rejected the claim on that basis, which seems to have been an inevitable result, and did not consider whether there could have been any other ground on which the payer might have succeeded.

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[25] The parties had agreed on this proposition. The fact that the payer had earlier received a cheque from the debtor for the amount which it advanced (which was not honoured) was held not to be inconsistent with this intention. For similar statements, see *Crosbie-Hill* v. *Sayer* [1908] 1 Ch. 866, 877 *per* Parker J., and the Indian case of *Gur Narain* v. *Shadi Lal* (1911) I.L.R. 34 Allahabad 102, where a mortgagee retained part of the funds which were to be lent, and used them to pay off a prior incumbrancer; it was held that he had been subrogated to the rights of the prior incumbrancer.

[26] *Highland Finance Ireland Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1998] 2 I.R. 180, 189. American courts tend also to permit subrogation where the payer paid at the request of the debtor: *Home Savings Bank of Chicago* v. *Bierstadt*, 168 Ill. 618; 48 N.E. 161; 61 Am. St. Rep. 146 (1897); *Schmid* v. *First Camden National Bank*, 130 N.J. Eq. 254, 266; 22 A. 2d 246 (Ch. 1941); *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945).

[27] *De Garis* v. *Dalgety & Co., Ltd.* [1915] S.A.L.R. 102, 154 *per* Buchanan T.J.; *Evandale Estates Pty. Ltd.* v. *Keck* [1963] V.R. 647; *Cid* v. *Cortes* (1987) 4 B.P.R. [97276] at 9393-4, Supreme Court of New South Wales, Equity Division, 1987 NSW LEXIS 7090; BC8701374, Young J., judgment delivered 13th May 1987.

[28] [1937] Ir. Jur. Rep. 40.

[29] [1937] Ir. Jur. Rep. 40, 43.

4.2.a Effect of Section 84 of the Building Societies Act 1976

In cases where it applies, section 84 of the Building Societies Act 1976[31] may operate in a manner equivalent to subrogation. That section provides that a statutory receipt endorsed by a building society on a deed of legal mortgage will operate to vest the legal estate in the person for the time being entitled to the equity of redemption. In *Pease* v. *Jackson*,[32] a mortgagor requested a third party to pay off a first mortgage on his property. The first mortgagee was a building society, which endorsed a receipt upon its mortgage when it received payment. The mortgagor executed a new, third, mortgage in favour of the third party. It was held that the receipt had operated to vest the legal estate in the third party, who therefore became entitled to the first mortgage.[33] It seems that the only basis on which the third party could be said to have been entitled to the equity of redemption was because of the presumption that, if he paid off the mortgage, he intended to occupy the position of the first mortgagee.

Another example of the application of the section to the present category of cases is provided by *Sangster* v. *Cochrane*.[34] In that case, a mortgagor, a solicitor, had mortgaged a house to a building society. He later requested the plaintiff, his client, to pay off the building society's mortgage, promising to grant him in turn a first legal mortgage. The plaintiff paid off the mortgage, and the building society endorsed a statutory receipt on the deed, and gave the deeds to the plaintiff. The mortgagor later granted the plaintiff a mortgage. The defendant was in possession of part of the mortgaged premises, under a deed executed after the mortgage to the building society, but before the plaintiff paid off the society. The plaintiff claimed that the society's mortgage subsisted, vested in him, as against the defendant. Kay J. adopted this proposition, feeling himself bound to follow the decision in *Pease* v. *Jackson*,[35] though he did so with reluctance. He said:

> "Apart from authority I should have thought that a stranger, not interested in the equity of redemption, paying off the mortgage, and desiring to obtain a transfer, could only do this by means of a conveyance from the building society, and that the receipt could not have the effect of vesting the property in him."[36]

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[30] See section 4.6, *post*.
[31] No. 18. The earlier equivalent provision was section 42 of the Building Societies Act 1874 (37 & 38 Vict., c. 42).
[32] (1868) L.R. 3 Ch. 576.
[33] The case was followed on similar facts in *Robinson* v. *Trevor* (1883) 12 Q.B.D. 423. See also *Marson* v. *Cox* (1879) 14 Ch. D. 140.
[34] (1884) 28 Ch. D. 298.
[35] (1868) L.R. 3 Ch. 576.
[36] (1884) 28 Ch. D. 298, 301-2.

The plaintiff in that case had made the payment at the request of the mortgagor, and on his promise to execute a mortgage which would have first priority. As the plaintiff was unaware of the defendant's rights, his payment can be regarded as having been made under a mistake, and the case is therefore akin to one where a lender is subrogated to the rights of a prior incumbrancer, where he took a security unaware of the existence of intervening incumbrances.[37]

4.3 Where the payment is made at the request of someone other than the Debtor

It appears that if a third party pays a debt at the request of someone other than the debtor, he will not be entitled to recover that payment from the debtor. This, it seems, is the case even if the person who makes the request is an agent of the debtor acting without or in excess of authority. However, if the money is received by the creditor in discharge of the debt owed by the debtor, the payer may be entitled to recover this amount from the debtor, or set it off against a separate action by the debtor against him.

4.3.a Payment made at the request of an Agent lacking Authority

An example of this type of case is the situation where a cheque is presented to a bank bearing the signature of one necessary authorising agent of the drawer, but not those of all necessary agents. In such a case, the cheque cannot be said to have been drawn with authority, and whatever the appearance of matters, the case is equivalent in law to one of a request for payment by a third party, without authority to act on behalf of the debtor.

This situation arose in *B. Liggett (Liverpool) Ltd.* v. *Barclays Bank Ltd.*[38] In that case, a bank paid cheques drawn on a company's account by persons without proper authority. The company sued the bank for money had and received to its use.[39] The various cheques had all been paid to trade creditors of the company. The bank claimed by way of defence that it was entitled to credit for all sums which had been so applied. Wright J. held that the bank was so entitled, as it had paid valid debts of the company, without increasing the company's liabilities. If the company's account with the bank had been in debit, then in effect the presentation of each cheque would have been equivalent to a request for a loan, and as the request would have been an unauthorised one, the case was analogous to that of unauthorised borrowing. If the company's account had been in credit, then the bank should be entitled to relief in the same way. He interpreted the situation in such a case as being a "misapplication ... of the credits which

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[37] See *post*.
[38] [1928] 1 K.B. 48.
[39] Wright J. rejected the defence of the bank based on the "internal management" rule (*Royal British Bank* v. *Turquand* (1856) 6 E. & B. 327), as the bank had been put on notice to ascertain that the directors had been validly appointed.

constitute the medium of exchange in place of cash."[40] As Sir Wilfrid Greene M.R. noted in *In re Cleadon Trust Ltd.*,[41] the case was really one where the bank itself paid the creditors.[42] In a later decision, *Liggett* was applied in a case where a signature of a co-drawer on a cheque was forged by the other drawer, but where the payee was a creditor of the drawers.[43]

In so far as that decision and certain others seemed to permit a payer to stand in the position of a creditor of a debtor, whose debt had been paid at the request of a fourth party, they appear to have been undermined by the later decision in *In re Cleadon Trust Ltd.*[44] In that case, one of the two directors of a company paid the debts of subsidiary companies at the request of the company secretary. The company itself was liable to pay the debts as guarantor. A meeting of the two directors purported to confirm some of these payments as being loans to the company, and they were entered as such in the books of the company. Although the meeting was quorate, the resolutions were invalid, as the articles provided that a director could not vote in respect of any contract in which he had an interest. The paying director now claimed to recover the amount which he had paid from the company. As the resolutions had been invalid, he could not claim that he had paid at the request of the company.

By a majority, the Court of Appeal held that he was not entitled to recoupment. Clauson L.J. regarded the case as being one of payment by a stranger, without any request by the company.[45] The payer's lack of authority to pay the debts was an absolute bar to his claim. He could only have obtained relief if the *company* itself or an agent with authority had used the funds to pay the creditors. Scott L.J. agreed that the payer should not recover, as his payment had been voluntary. He also felt that the company's inability to borrow from the payer in the circumstances was a conclusive answer to the claim. The company could not be bound to reimburse the payer, as it had not taken any action to use the money advanced.

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[40] [1928] 1 K.B. 48, 63-4. Wright J. thought that the case could not be one of subrogation because the rights of the creditors who had been paid were not secured ones. This was a *non sequitur*, as two commentators rightly observed: Ellinger and Lee, "The 'Liggett' defence: a banker's last resort," [1984] L.M.C.L.Q. 459, 473. However, those authors fall into a different error when they deny the relevance of subrogation on the ground that subrogation is only available where a party secondarily liable pays a debt for which another is primarily liable. This is an accurate description of many instances of subrogation, such as that of insurers and sureties, but not of all instances. See section 1.4, *ante*.

[41] [1939] 1 Ch. 286.

[42] See also *A.L. Underwood Ltd.* v. *Bank of Liverpool* [1924] 1 K.B. 775, 794 *per* Scrutton L.J.; *Royal Bank of Canada* v. *Huber* (1971) 23 D.L.R. (3d) 209.

[43] *Jackson* v. *White and Midland Bank Ltd.* [1967] 2 Lloyd's Rep. 68. See also the decisions in *In re Manchester, Middleton and District Tramway Co.* (1893) 68 L.T. 820, 826, *In re Cork and Youghal Railway Co.* (1869) L.R. 4 Ch. 748 and *In re Bagnalstown and Wexford Railway Co.* (1870) I.R. 4 Eq. 505, overruling (1870) I.R. 4 Eq. 172, considered *post*.

[44] [1939] 1 Ch. 286, affirming [1938] Ch. 660.

[45] He felt that the decision in *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234 precluded recovery by the payer. On this, see section 4.6.d, *post*.

Sir Wilfrid Greene M.R. dissented, holding that the payer could recover. He held that the company could not succeed on the ground that the company had acquiesced in the payments, as the company could not be said to have had "knowledge" that the payer expected to be recouped. He also held that the cases where a lender under an invalid contract had been subrogated to the rights of creditors paid off using the funds lent were irrelevant. Having said this, he nonetheless held that the payer should recover on the ground that the secretary had in effect borrowed on the company's behalf, as an agent without authority, and the money had been used to discharge valid debts of the company.[46] He also regarded *Liggett*[47] as being a close precedent. He held that it was not necessary for this result that the agent who had made the request should have had general authority. In the present case, the company secretary could never have had authority to make such a request, but that did not disentitle the payer to relief. Further, the fact that the debts discharged were those of subsidiaries, rather than those of the company itself, did not alter the payer's rights, as the company was liable as guarantor of the subsidiaries' liabilities.

Mitchell's conclusion from the majority judgment in the case is that the payment was not effective to discharge the debt of the company.[48] Considering the case to be one of mistake by the payer, he concludes, on the strength of this and the later case of *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.*,[49] that a mistaken payment by an unauthorised intervener does not have the effect of discharging the liability of the debtor.[50] He therefore, effectively, concludes that the *Liggett* decision was wrong. However, in *Simms*, Robert Goff J. stated that a mistaken payment could not be recovered if the money had been paid for good consideration or if the recipient had in good faith changed his position on the strength of the payment. If the creditor accepts the payment as a discharge of the debtor's debt, then it would seem that each of these limitations applies, and, as far as the creditor is concerned, the debt has been discharged.[51] If the creditor has treated it as discharged, the question arises whether the debtor should be allowed to argue, as against the payer, that it has not been discharged.[52] The view taken here is

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[46] He felt that the cases of *Bannatyne* v. *D. & C. MacIver* [1906] 1 K.B. 103 and *Reversion Fund and Insurance Co., Ltd.* v. *Maison Cosway Ltd.* [1913] 1 K.B. 364 applied (as to which, see section 5.7.a, *post*). He stated that the principle of these cases should be no less applicable to cases where the payer paid the creditor directly, rather than lending to the agent, who then paid the creditor.

[47] [1928] 1 K.B. 48.

[48] *Op. cit.*, 128-9.

[49] [1980] Q.B. 677.

[50] *Op. cit.*, 111. See *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677, 699-700 *per* Robert Goff J. Similarly, Virgo, "Recent Developments in Restitution of Mistaken Payments," (1999) 58 C.L.J. 478, 480-1. The subrogation of payers under a mistake is considered in section 6.2, *post*.

[51] Virgo, *op. cit.*, 481, distinguishes between the two. He argues that if there is good consideration, *i.e.*, a discharge, then there is no enrichment, so the payer's case fails without moving to a consideration of defences.

[52] See also Friedmann, "Payment of Another's Debt," (1983) 99 L.Q.R. 534, 558, arguing that if the creditor accepted the payment in good faith in discharge of the debt, ignorant of the mistake, then he may

that he should not. This view can certainly not be asserted as clearly representing the current law. However, it is felt that it would be a desirable approach for the law to take. Alternatively, if one cannot accept that an unauthorised payment, even if accepted in discharge by the creditor, can render the debtor liable to the payer, by analogy with the view of Lord Jenkins in *Ghana Commercial Bank* v. *Chandiram*,[53] it is arguable that the payer should be held entitled to subrogation to the creditor's rights, even if he had no right to indemnification from the debtor.[54] In cases where the payer did not pay *bona fide*, it might be desirable as a matter of policy to hold that, even if the creditor accepted such a payment in discharge, the debtor should not thereby become liable to the payer unless he chose later to adopt the payment.[55]

In some cases, the debtor may so act or make such a representation to the creditor that he will be estopped from denying that the payer had authority to discharge his debt.[56] In such a case, the payer might enjoy ostensible authority. Of course, if there was no valid pre-existing debt which was paid by the intervener, then there can be no discharge and no defence.[57]

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retain the money and the debt must be treated as discharged. See also Meier, "Mistaken Payments in Three-Party Situations: A German view of English law," (1999) 58 C.L.J. 567, 569-70.

[53] [1960] A.C. 732, 745; section 4.1, *ante*.

[54] *Cf. Mathews* v. *Aikin*, 1 N.Y. 595, 602 (1848) *per* Johnson J. (even if the debtor has a defence to an action for indemnification by the payer, the creditor should not be allowed to raise it, and should transfer his securities to the payer on request).

[55] For example, Lightman J. concluded that "it may be that the plaintiff who is the victim of conversion need not give credit for the application of the converted funds in the discharge of his debts unless the plaintiff or his duly authorised agent authorised such application": *National Employers' Mutual General Insurance Association Ltd. (in liq.)* v. *A.G.F. Holdings (U.K.) Ltd.* [1997] 2 B.C.L.C. 191, 200, referring to *Liggett* and *Cleadon*.

[56] Mitchell, *op. cit.*, 112.

[57] Although this sounds obvious enough, it may not be in certain circumstances. In *National Shawmut Bank of Boston* v. *Fidelity Mutual Life Insurance Co.*, 318 Mass. 142; 61 N.E. 2d 18; 159 A.L.R. 478 (1945), a forger obtained a loan from the defendant through a forgery of the signature of an insured. The defendant purportedly obtained a lien on the policy to secure this loan. The forger then obtained another loan from the plaintiff, again forging the name of the insured and purportedly using the policy as security. The forger then used the loan from the plaintiff to pay off the defendant. The defendant then discharged its lien on the policy. The defendant was held liable to repay the plaintiff the amount which it had received. It was held that the money lent by the plaintiff had at all times belonged to the plaintiff. Further, the money received by the defendant had purportedly been applied in discharge of a non-existent debt, and this could not be a giving of consideration or a change of position. The defendant retained its right of action against the forger. See also *Cundy* v. *Lindsay* (1878) 3 App. Cas. 459, *Grand Lodge, Ancient Order of United Workmen* v. *Towne*, 136 Minn. 72; 161 N.W. 403 (1917) (action for money had and received could only lie if the money received by defendant was that of the plaintiff, but payment induced by fraud did not cause transfer of property; hence, the plaintiff succeeded), *Newell* v. *Hadley*, 206 Mass. 335; 92 N.E. 507 (1910), and *Bremer* v. *Williams*, 210 Mass. 256; 96 N.E. 687 (1911). If property had passed to the forger in *National Shawmut Bank*, then it seems that the plaintiff would have lost. This was the conclusion in the indistinguishable case of *Walker* v. *Conant*, 69 Mich. 321; 37 N.W. 292 (1888). *Cf. Citibank N.A.* v. *Brown Shipley & Co. Ltd.* [1991] 2 All E.R. 690, where, in effect, the plaintiff bank directly paid the defendant bank through the inducement of a forger. It was held that property had passed

4.4 Persons who pay the Debt of another under compulsion of legal process

If one is compelled to pay the debt of another, the compulsion is a sufficient element to distinguish the case from that of a stranger voluntarily paying the debt of another.[58] In this case, the payer is normally held entitled to reimbursement from the actual debtor.[59] In America, it has been stated as a general principle that "[s]ubrogation is broad enough to include every instance in which one party pays a debt for which another party is responsible so long as the payment was made under compulsion or to protect the party making the payment and in the discharge of some existing liability."[60]

One clearly cannot point to any contractual basis for this type of action, which must be restitutionary. Where recourse by subrogation is recognised in such a case, it would appear that it must also be directed at the reversal of unjust enrichment. However, there may be scope for controversy in deciding who is a payer under legal compulsion. A surety, who became bound at the request of the principal debtor may arguably be regarded either as a payer under legal compulsion, or as a payer at the request of the debtor.[61] Where a co-debtor pays the entire of the debt, he is entitled to seek contribution from his co-debtors on the same basis. Mitchell states that an insurer must be considered to pay under legal compulsion when it pays pursuant to its contractual obligation.[62] It seems less strained, however, to conclude that the insurer pays because of a voluntary obligation into which it entered, and that its entitlement to subrogation arises either out of contract or out of an equitable recognition of the principle of indemnity.

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from the plaintiff to the defendant. The case is irreconcilable with the Massachusetts decision in *National Shawmut Bank*. See also Meier, *op. cit.*, 80-2 and *post*.

[58] The subject of volunteers was considered in more detail in section 3.8, *ante*.

[59] *Exall* v. *Partridge* (1799) 8 T.R. 308; *Pownal* v. *Ferrand* (1827) 6 B. & C. 439; *Moxham* v. *Grant* [1900] 1 Q.B. 88, 93 (*per* Collins L.J.- where there was "a payment under compulsion by one of a sum of money for which another was liable, and in relief of that other - there is an implication of law that the payer has a right to be recouped by the person relieved"); *North* v. *Walthamstow Urban District Council* (1898) 62 J.P. 836, 838 *per* Channell J. ("it is a well known principle that if one person is compelled to do a thing which another person is legally compellable to do, then a request is implied, and an action is maintainable by the party compelled against the party compellable... I do not think that the compulsion must be irresistible... I think the law implies such a promise where there is practical compulsion"); *East Cork Foods Ltd.* v. *O'Dwyer Steel Co. Ltd.* [1978] I.R. 103, 109, 111 (going to the extent of saying that the sum held by the recipient, who was not in fact entitled to receive it, was held on constructive trust). To the contrary was *Sweeney* v. *Moy* [1931] L.J. Ir. 42, where the court assumed that the action for reimbursement was contractual in nature and denied any right to indemnification where there had been no privity between the parties. The decision was clearly wrong.

[60] *In re Ted True, Inc.*, 94 B.R. 423, 427 (Bkrtcy. N.D. Tex. 1988), referring to *Liberty Mutual Insurance Co.* v. *Borsari Tank Corporation*, 248 F. 2d 277, 288 (2nd Cir. 1957).

[61] Birks, *op. cit.*, 186, regards the surety as being a payer under legal compulsion, as does Mitchell, *op. cit.*, 54-7.

4.4.a Where Sub-lessee was forced to pay head rent

One example of a case where a payer under legal compulsion was held entitled to indemnification from the debtor was that where a sub-lessee's chattels were distrained by the head-lessor, or he was otherwise forced to pay rent to the head-lessor. It was held that he could recover amounts so paid from the head lessee by an action for money paid to the use of the latter.[63] Certain old cases imposed illogical limitations on such actions,[64] but these were over-ruled.[65] A different series of Irish cases allowed the reimbursement of a sub-lessee who paid in the absence of legal compulsion by imposing an equitable lien on the interest of the head lessee in favour of the paying sub-lessee.[66] The justification for this was that the payment had been made in order to preserve the sub-lessee's property.

4.4.b Persons who are compelled to pay taxes due from another

The situation of co-owners of land who are compelled to pay a land tax which should have been borne, at least in part, by their fellow co-owner is considered in a later chapter. There are other cases

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[62] *Op. cit.*, 24, and chapter 6.

[63] *Exall* v. *Partridge* (1799) 8 T.R. 308.

[64] *Moore* v. *Pyrke* (1809) 11 East 52 (where the underlessee sued for money paid to the use of the intermediate lessee, and failed on the ground that the "money" was never his - *i.e.*, his goods had been taken and sold, but he himself had paid no money), followed in Ireland in *Whitla* v. *Whitla* (1824) 2 Fox & S. 207 (the goods of one of three co-lessees were taken in execution by the lessor; this co-lessee was held not entitled to sue one of his fellows for money paid to his use); *Geraghty* v. *Darcy* (1829) 2 Law Rec. (o.s.) 499 (*per* Serjeant Goold) and *McCarthy* v. *McCarthy* (K.B.), there cited.

[65] In favour of such an action: *Exall* v. *Partridge* (1799) 8 T.R. 308; *Byrne* v. *Shipley* (1829) 2 Hud. & Bro. 195; *Miller* v. *Attlee* (1849) 13 Jur. 431; *Ryan* v. *Byrne* (1883) 17 I.L.T.R. 102 (sub-lease granted in breach of a covenant by the intermediate lessee against sub-leasing without the consent of his landlord; held that the sub-lessee still had lawful possession, and was entitled to protect it by paying the head rent). In *O'Geran* v. *McSwiney* (1874) I.R. 8 Eq. 500, 624, in this situation, the sub-lessee was declared a salvage creditor of the intermediate lessee, and the amount of head rent paid by him was declared a charge on the intermediate leasehold interest. In *Ahearne* v. *McSwiney* (1874) I.R. 8 C.L. 568, which concerned a different sub-lessee of the same intermediate lessee, the sub-lessee paid head rent, without demand or threat of distress by the head lessor. The sub-lessee was then sued for rent by the intermediate lessee, and paid. After that time, the intermediate lessee obtained credit from the head lessor for the sum paid by the sub-lessee. It was held that, although the sub-lessee's payment may have been initially a voluntary one, it had been adopted by the intermediate lessee, who was thereby made liable to the sub-lessee. See "Indemnity in Respect of Goods Seized for Another's Debt," (1885) 19 I.L.T.S.J. 388.

[66] *Locke* v. *Evans* (1823) 11 Ir. Eq. R. 52 (note); *O'Geran* v. *McSwiney* (1874) I.R. 8 Eq. 500, 504-5; 624; *Ahern* v. *McSwiney* (1874) 9 I.L.T.R. 13. In *Allison* v. *Jenkins* [1904] 1 I.R. 341, it was held that in such a case, the paying sub-lessee was entitled to contribution towards his payment of the head rent from other sub-lessees, Porter M.R. drawing a comparison with cases of general average contribution (at 348-9). On the other hand, in *Craig* v. *Attorney General* [1926] N.I. 218, the claimant paying sub-lessee had caused a receiver to be appointed over another sub-leasehold interest (Whiteacre) which was liable to indemnify that of the claimant (Blackacre). That receiver had misapplied rents of Whiteacre to paying the head rent on Blackacre before paying the head rent on Whiteacre, which fell into arrears. The claimant then paid the head rent on Whiteacre, and claimed to recover this from the sub-lessees of Whiteacre (as a lien on Whiteacre). The claim was dismissed, on the ground that the claimant, the putative salvor, was

where persons were compelled to pay rates or taxes, without any consequential effect of protecting their property. In such cases, the payer is generally still held entitled to reimbursement from the real or proper taxpayer.[67]

4.5 Payments made under necessity

There are certain categories of cases where one makes a payment in the absence of legal compulsion, but where there may be either a degree of "moral compulsion,"[68] or alternatively a factor which renders it desirable in the interest of the payer to make the payer. Mitchell dislikes the term "moral compulsion," and prefers to identify a policy which encourages persons to act so as to preserve the

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responsible for the risk, which arose out of the irregular management by his agent, the receiver. See section 4.6.c, *post*.

[67] *E.g.*, *In re P.J. McCourtney Ltd.*, unreported, 1960, Budd J., noted, "Company Liquidation: Rates paid by Landlord," (1960) 94 I.L.T.S.J. 240 (under section 5 of the Mercantile Law Amendment Act 1856); *Boone* v. *Martin* (1920) 53 D.L.R. 25, discussed by Mitchell, *op. cit.*, 63-4; *In re Burstein; Ex parte Peace Bridge Brokerage Ltd.* (1964) 45 D.L.R. (2d) 207 (customs broker liable to pay duty to crown, held subrogated under equivalent of section 5 of the Mercantile Law Amendment Act 1856 to the crown's preferential claim in the bankruptcy of the debtor); *Peace Bridge Brokerage Ltd.* v. *Bank of Montreal* (1992) 7 O.R. (3d) 682; 9 T.T.R. 139 (while the broker was subrogated to the crown's rights, on the facts these were restricted to a preferential claim in bankruptcy, and could not prevail against an existing security interest held by the defendant); *Resource Plastics Inc.* v. *W. Pickett & Bros. Customs Brokers Inc.* 1995 Ont. C. J. LEXIS 3185, Ontario Court (General Division), in Bankruptcy, judgment delivered on the 26th October, 1995. See also *Moore* v. *Gillingham*, 22 Wash. 2d 655; 157 P. 2d 598 (1945), where a purchaser of land who had contracted to sell on his interest, and to pay taxes which were a lien on the property, was held not to have acted as a volunteer in paying them, and was thus held entitled to indemnification from the original vendor. In *In re Ted True, Inc.*, 94 B.R. 423, 427-8 (Bkrtcy. N.D. Tex. 1988), a purchaser of fuel was secondarily liable to pay tax on it. On payment, it was held that he was entitled to subrogation to the State's rights against the producer, who was primarily liable.

[68] P. Birks, *op. cit.*, 193-202. Examples include cases where one not liable to do so paid funeral expenses (*Jenkins* v. *Tucker* (1788) 1 H. Bl. 90), and certain cases where one party to a contract acted as an "agent of necessity." In other words, he did something to the other party's property without any authority, but in circumstances where it was necessary to preserve the property or protect the interests of the other party. Compare the Irish cases of salvage, section 4.6, *post*. The idea that a moral obligation was sufficient compulsion to allow recovery was accepted in *Campbell* v. *Foster Home Association*, 163 Pa. 609; 30 A. 222; 26 L.R.A. 117; 43 Am. St. Rep. 818 (1894): "Subrogation will not be decreed in favor of a mere volunteer who without any duty, moral or otherwise pays the debt of another." This statement was further approved in *Michigan Millers Mutual Insurance Co.* v. *United States Fidelity and Guaranty Corporation*, 306 Pa. Super. 88, 92; 452 A. 2d 16, 18 (1982). However, in that case, the insurer of one defendant who had been held to be jointly and severally liable for a wrong brought proceedings claiming indemnification from the insurer of another defendant. Thus, the plaintiff insurer had plainly been under a legal duty to pay.

property of others.[69] Mitchell suggests that insurers who pay when not strictly bound so to do should be regarded as "necessitous interveners."[70]

4.6 Persons who make a payment in order to protect their own Interest

There are numerous cases where a person with an interest in property pays a creditor who holds an incumbrance on it. In some cases, it is apparent that this is done to protect the existence of the payer's interest, which might otherwise be defeated.[71] There are other cases where it is not immediately obvious that there was any immediate threat to the payer's interest, but where it is presumed that the purpose of his payment was to protect that interest, and he is thus held to have been subrogated to the rights of the creditor whom he paid.[72] American cases frequently recognise that one who pays a debt in order to protect an interest of his own, is not a volunteer, and may be entitled either to reimbursement from the debtor, or to subrogation to the creditor's rights against him.[73] The Irish courts have exercised a distinct but parallel

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[69] *Op. cit.*, 101. Examples given include *In re Okotoks Milling Co. Ltd.* (1912) 8 D.L.R. 76, where directors paid an insistent chargee of the company, and procured an assignment of the charge to other creditors. The payment had been made to prevent the chargee from enforcing his security, and thus to protect the company. It was held that the directors were entitled to the value of the proceeds of realisation of the charge after the assignee creditors had been paid.

[70] *Op. cit.*, 24. He states that this is because of a judicial policy to encourage settlement of doubtful policy claims (*ibid.*, and 105). *Cf.* Quinn, *op. cit.*, 1380, who regards Mitchell's formulation as over-broad, but who states:

> "sound social policy encourages insurers to err on the side of caution when rejecting claims. This means that public policy favors both the payment of some undeserving insureds and the overpayment of some disputed claims. One support for this public policy norm is the desire to encourage the insurance industry to finance losses."

[71] *E.g.*, *Johnson* v. *Royal Mail Steam Packet Co.* (1867) L.R. 3 C.P. 38, where a mortgagee of a ship paid off the crew, whose wages were a prior lien on the ship, and was held entitled to recover that amount from the owners. However, there can be no subrogation to the lien of the crew, unless the payer obtained the prior leave of the court to make the payment: *The "Kammerhevie Rosenkrants"* (1822) 1 Hagg. Adm. 62; *The "John Fehrman"* (1852) 16 Jur. 1122; *The "Duna"* (1861) 6 Ir. Jur. (n.s.) 358; 1 Mar. L.C. 159; 5 L.T. 217; *The "Cornelia Henrietta"* (1866) L.R. 1 A. & E. 51; *The "Petone"* [1917] P. 198; *The "Leoborg" (No. 2)* [1964] 1 Lloyd's Rep. 380; *The "Berostar"* [1970] 2 Lloyd's Rep. 403; *The "Vasilia"* [1972] 1 Lloyd's Rep. 51; *The "Guiseppe di Vittorio" (No. 2)* [1998] 1 Lloyd's Rep. 661, 672. *Cf. Motokov Foreign Trade Corporation* v. *Fermoyle Investments Ltd.*, unreported, High Court, McMahon J., judgment delivered on the 25th January 1985, where an operating agent paid sailors' wages, and claimed to have been subrogated to their lien. McMahon J. rejected the claim, stating (at 3): "An agent who, on behalf of a principal, pays a creditor of the principal is not subrogated to any rights the creditor might have against the principal. There is no maritime lien to which [the agent] could be subrogated. The wages discharged by them on behalf of the owners extinguished any lien in respect of such wages."

[72] The cases often speak in terms of the payer being presumed to keep a charge "alive" for his own benefit. For a recent unusual example, see *Kleinwort Benson Ltd.* v. *Vaughan*, unreported, Court of Appeal of England and Wales, 13th December 1995.

[73] *E.g.*, *American Oil Co.* v. *McMullin*, 508 F. 2d 1345 (10th Cir., 1975), where the lessor of a service station and associated equipment paid off a tax lien which had been asserted by the revenue authority against the lessee, this being the only way in which the lessor could recover possession of the station and

jurisdiction to impose an equitable lien on property in favour of one with an interest in it who pays a debt in order to preserve his rights and those of others in the property. The doctrine owes some similarities to the civil law quasi-contractual right of action arising out of the management of another's affairs, although it generally provides a proprietary remedy only, and not a personal one. The most important difference between the two doctrines is that the civil law only granted a remedy in cases where the manager acted to further the interest of the other, and not where he himself had an interest.[74] In sharp contrast, a creditor may only make an equitable salvage claim where he acted to protect his own interest and in so doing, preserved the interests of others.[75] In *Fetherstone* v. *Mitchell*,[76] Moore J. stated forcefully that a person without any interest in an estate who advanced money to ensure its preservation would not be entitled to a salvage lien: "The answer of a Court of Equity to such a person would be 'You had no business to interfere, you being a mere volunteer who chose to advance this money, and you must abide the consequences of the act.'"[77] He continued that no person having an incumbrance on or other proprietary interest in an estate would make a payment *except* in order to protect his own interest.[78] Notwithstanding this requirement of self-interest, the doctrine has been brusquely rejected in England on the basis that the payer is no more than an intermeddler.[79]

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equipment. It was held that the payment was not voluntary, and that the lessor had been subrogated to the tax authority's lien.

[74] J.P. Dawson, *Negotiorum Gestio*, chapter 17 in P. Schlechtriem (ed.), *International Encyclopedia of Comparative Law*, X, at § 97 (the payer, in order to recover in an action on the management of another's affairs, must have paid with the intention of managing *that other's* affairs). *Cf.* Goff and Jones, *op. cit.*, 61-3, observing that restitutionary relief has often been refused where a payer acted in his own self-interest, incidentally conferring a benefit on another. However, they acknowledge that this is not an absolute rule barring recovery, where another element such as compulsion or necessity is present.

[75] See section 4.6.a, *post*.

[76] (1848) 11 Ir. Eq. R. 35.

[77] (1848) 11 Ir. Eq. R. 35, 44. So, where a payer has no interest in the property, he will be denied relief: *Kavanagh* v. *Waldron* (1846) 9 Ir. Eq. R. 279; *O'Loughlin* v. *Dwyer* (1884) 13 L.R. Ir. 75, 80; *In re Power's Policies* [1899] 1 I.R. 6, 27 *per* Holmes L.J.; *Munster and Leinster Bank* v. *McCann* [1937] Ir. Jur. Rep. 40; *In re Kavanagh, Ltd.* [1952] Ir. Jur. Rep. 38. One who pays in the mistaken belief that he has a property interest may, however, be permitted a lien for payments made which saved the property: see *post*.

[78] He concluded from this that the payer must have anticipated when he made his payment that his existing security or other interest would adequately reimburse him his original demand, together with the salvage payment, and that his salvage lien should not therefore be granted any higher priority than his original claim. The majority of the court, Jackson J. and Brooke M.C., disagreed with this latter holding.

[79] *In re Leslie; Leslie* v. *French* (1883) 23 Ch. D. 552; see section 4.6.d, *post*. In this regard, one may note the observation of Professor Zimmermann on the management of affairs:

> "English law ... does not possess a doctrine of *negotiorum gestio* ... a highly characteristic trait, for it reflects the traditional individualism and the reserved mentality of the English people. Management of another's affairs is regarded, first and foremost, as an undue curtailment of that other person's autonomy, and the unsolicited gestor is often somewhat contemptuously referred to as an officious meddler."

(R. Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), 435). See also Visser, "Unjustified Enrichment," chapter 16 in R. Zimmermann and D. Visser (eds.), *Southern Cross: Civil Law and Common Law in South Africa* (1996), 548. On the other hand, Dawson, *op. cit.*, §

In *Ahern* v. *McSwiney*,[80] Sir Joseph Napier stated that "[t]he general principles which rule the question of salvage are consistent with natural justice - they are somewhat like those with which we are familiar in Admiralty cases, under the name of general average."[81]

In the influential Irish case of *In re Power's Policies*,[82] Holmes L.J. summarised the requirements for a salvage payment to be entitled to rank as a charge:[83]

> "1. It must have had the effect of saving for the benefit of everyone interested property which would otherwise have been lost.
>
> "2. It must be made by a person having a charge on or an interest carved out of the estate of the ultimate owner of such property.
>
> "3. The salvagor must make it voluntarily for his own advantage, and not in pursuance of an obligation or in the performance of a duty, or as the agent of another."

He added that the burden of proving each of these elements fell on the claimant. While this summary cannot be taken as definitive, it has been followed in later cases,[84] and appears to be consistent with earlier authority.

108, felt that English law would recognise such an action where it was just and reasonable to do so, referring to *Owen* v. *Tate* [1976] 1 Q.B. 402, on which, see section 3.8.a, *ante*.

[80] (1874) 9 I.L.T.R. 13.

[81] (1874) 9 I.L.T.R. 13, 14. In *In re Power's Policies* [1899] 1 I.R. 6, 23, FitzGibbon L.J. noted, however, of the doctrines of salvage and graft (a constructive trust imposed on a fiduciary in certain circumstances to prevent him from profiting from his position):

> "It is remarkable that these terms, so long and familiarly known here, like some other Irish products, do not seem to find favour in England. Our English brethren have objected to the introduction into equitable terminology of a word borrowed from Admiralty law, and they complain that it is misleading because the maritime lien for salvage does not rest on request, privity, acquiescence, or even knowledge, and arises upon the saving of the property by a stranger, or even against the owner's will. Equity, on the contrary, whether in England or Ireland, never gives a lien, or charge, for money paid for, or with the effect of, preserving property, unless there is some recognised privity or relation between the parties, or between the preserver and the property."

[82] [1899] 1 I.R. 6.

[83] [1899] 1 I.R. 6, 27. He seems to have deduced this list from a consideration of the cases of *Locke* v. *Evans* (1823) 11 Ir. Eq. R. 52 (note); *Fetherstone* v. *Mitchell* (1848) 11 Ir. Eq. R. 35 and *In re Tharp* (1852) 2 Sm. & G. 578 (note).

[84] Holmes L.J.'s summary was adopted by Kennedy C.J. in *Munster and Leinster Bank* v. *McCann* [1937] Ir. Jur. Rep. 40, 41.

4.6.a Justification for Granting a Proprietary Remedy

Where a person having an interest in property pays a debt which he is not personally liable to pay, with the intention of preserving the property which would otherwise be forfeited or realised by a prior creditor, the payer may in some circumstances be granted an equitable lien on the property. This lien is normally given priority over other incumbrances, the reasoning being that the payer has acted in the interest of everyone with an interest in the property, and should therefore be allowed to recoup his payment before other creditors are paid. This doctrine was applied frequently in Ireland at one time, though it received only piecemeal application in England.[85] In *Ahern* v. *McSwiney*,[86] Christian L.J. expressed reservations about this doctrine:

> "Why is what was simply a contract demand, sounding in personalty throughout, suddenly to be turned into a charge on the lands? The equity cannot rest on contract ... The Courts of Equity have no right to give new remedies to parties which they have not provided for themselves. I do not think, as a general rule, that a Court of Equity is to superinduce, on a personal contract, an equitable charge in the nature of an incumbrance."[87]

He accepted that equities existed which were superinduced on a contract, such as a surety's right to contribution from co-sureties who had been bound by separate contracts. However, he saw no good reason to bring the present case within that class.

The answer offered to Christian L.J.'s question in an earlier case, *Fetherstone* v. *Mitchell*,[88] was that "the payment is in a manner compulsory and that, in the common danger, it is for the benefit of all to encourage an advance of money, without which [the debtor, or person who should bear the burden] and every one of his creditors must suffer a serious loss."[89] Christian L.J.'s objection undoubtedly carries some force, and it is notable that Irish and English courts have shown a reluctance on a number of occasions to impose a lien or trust in favour of someone who would otherwise rank as an unsecured

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[85] See, in general, "The Doctrine of Salvage Payments," (1913) 47 I.L.T.S.J. 119, 125; "Salvage Payments in Equity," (1953) 87 I.L.T.S.J. 146, 151; Sutton, "Payment of Debts Charged upon Property," chapter 4 in A. Burrows (ed.), *Essays on the Law of Restitution* (1991).

[86] (1874) 9 I.L.T.R. 13.

[87] (1874) 9 I.L.T.R. 13, 13-14.

[88] (1848) 11 Ir. Eq. R. 35.

[89] (1848) 11 Ir. Eq. R. 35, 42 *per* Brooke M.C. He continued that "It is considered beneficial for all parties to give the most ample remedies to him who has saved the common security, provided they are confined to that property which, but for his advance, would have been lost to every one concerned." One may compare the later English case of *Strutt* v. *Tippett* (1890) 62 L.T. 475, where a payer unsuccessfully claimed a lien on a different property for a sum which he had paid to save his own.

creditor.[90] There has been considerable critical comment on the prospect of a person with a personal claim obtaining preference through the imposition of a trust or lien.[91]

The justification however, appears to be the payer will not recover the amount of the benefit which he conferred on prior incumbrancers unless his claim to reimbursement is given priority over them. It may well be proper to deny any personal claim against other owners of the property. However, if the payer establishes that his payment saved the property, they should not be allowed to deny that they have benefited by it.

Although numerous Irish cases exist concerning payments made to prevent the physical destruction of property, those which concern payment of a debt in order to preserve the property are of more interest for present purposes. Two situations will be considered. First, the case of a sub-lessee or his creditor who pays head rent to protect the sub-lessee's interest. English law generally acknowledges a personal right of indemnification in these circumstances.[92] Irish law has gone further in recognising a lien. The second situation concerns the payment of premiums on an insurance policy by a person with a part interest.

4.6.b Payment of Head Rent by Sub-Lessee or Creditor of Sub-Lessee

In a case where a sub-lessee paid the head rent, Sir Joseph Napier observed that he was not a mere volunteer, as he had paid in order to preserve the interest which should have been preserved for him by the head lessee.[93] The lien was justified on the ground that it was "natural equity that the money [the sub-lessee had] so advanced should be considered as a lien on the lands, prior to all other incumbrancers fastened on them ... - the payment of the money having preserved the interest for all the incumbrancers."[94] Similarly, persons with a proprietary interest *in* a sub-lessee or part-owner's interest were held entitled to a *paramount* lien on the head-lessee's interest or on the property as a whole in the case of part-ownership of land subject to a common charge.[95]

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[90] *In re Barrett Apartments Ltd.* [1985] I.R. 350; *Space Investments Ltd.* v. *Canadian Imperial Bank of Commerce Trust* [1986] 1 W.L.R. 1072, 1074 *per* Lord Templeman. One may also regard in this light the decision of the Supreme Court in *Highland Finance (Ireland) Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1998] 2 I.R. 180, affirming [1992] 1 I.R. 472.

[91] See, *e.g.*, Mitchell, *op. cit.*, 82-3; Goff and Jones, *op. cit.*, 84-91.

[92] See section 4.4.a, *ante*.

[93] *Ahern* v. *McSwiney* (1874) 9 I.L.T.R. 13, 14.

[94] *Ibid.*

[95] In *Fetherstone* v. *Mitchell* (1848) 11 Ir. Eq. R. 35, the plaintiff, a judgment creditor whose judgment gave him a lien on the interest of a life tenant in lands held in *quasi* fee under a lease for lives renewable forever, paid arrears of head rent at the request of the life tenant. It was held that he was entitled to a lien as salvage creditor, as a first charge on the lands, affecting also the remaindermen, and that he was further entitled to a decree for sale of the lands in order to enforce the lien (to which he had no right at that time as a mere judgment creditor, his judgment having been recovered prior to the entry into force of the

4.6.d Cases of the payment of premiums on a Life Insurance Policy by a Person interested in the Proceeds thereof

Although the courts in England at first seemed ready to countenance a lien on the basis of a salvage payment, they later turned their face against the doctrine.[96] The Irish view has been far more expansive. The English hostility was first voiced in *In re Leslie; Leslie* v. *French*.[97] In that case, a husband paid the premiums on a policy on the life of his wife, later assigning it to trustees for his and her benefit. After his death, his executor claimed to be entitled to reimbursement from the wife. Since the husband had had no interest in the property at the time of making the payments which gave rise to the dispute, the Irish cases would probably not have recognised a right to a salvage lien. Fry L.J. brusquely rejected the notion that the husband's payments entitled him to a lien. He treated the case, however, as one of payments by a part-owner, saying: "with regard to payments made by a part owner, it appears to me that, except by contract, such payments give no title to the party making them against the other part owner or part owners of a policy."[98] On the facts of the case, it is doubtful whether it was necessary to make any such broad assertion, which in any case contradicts a considerable body of authority on the effects of payments made by part-owners of other types of property. Fry L.J. then gave a list of cases where he thought a payment could give rise to a lien:

(i) where the payment was made under a contract with a beneficial owner of the policy;

(ii) under a trustee's right of indemnity from the trust funds;[99]

(iii) where one paid premiums at the request of a trustee, and was subrogated to his right of indemnity;

(iv) where a mortgagee paid the premiums to preserve his security, and added them to the amount of his debt.[100]

Debtors (Ireland) Act 1840 (3 & 4 Vict., c. 105), section 19). See also *Hamilton* v. *Denny* (1809) 1 Ball & Beatty 199, 202 *per* Lord Manners L.C., *Kehoe* v. *Hales* (1843) 5 Ir. Eq. R. 597, *Hill* v. *Brown* (1844) 6 Ir. Eq. R. 403 and *Burrowes* v. *Molloy* (1845) 2 J. & La T. 521; 8 Ir. Eq. R. 482.

[96] See *Burridge* v. *Row* (1842) 1 Y. & C. Ch. 183, affirmed (1844) 13 L.J. Ch. 173; 8 Jur. (o.s.) 299; *Gill* v. *Downing* (1874) L.R. 17 Eq. 316; *Shearman* v. *British Empire Mutual Life Assurance Co.* (1872) L.R. 14 Eq. 4; "Insurance Premiums and the Doctrine of Salvage," (1887) 31 S.J. 344. Commenting on English cases prior to *In re Leslie; Leslie* v. *French* (1883) 23 Ch. D. 552, the writer of that article states that "[f]rom these cases it is clear that anyone interested in the policy might pay the premiums and expect to obtain a lien upon it for the amounts." *Cf. Kavanagh* v. *Waldron* (1846) 9 Ir. Eq. R. 279.

[97] (1883) 23 Ch. D. 552.

[98] (1883) 23 Ch. D. 552, 563.

[99] See *In re Smith's Estate; Bilham* v. *Smith* [1937] 1 Ch. 636. If there are no trust funds available, a trustee who advances his own funds to make a payment may acquire a lien: *Clack* v. *Holland* (1854) 19 Beav. 262. However, this lien only extends to property which is comprised in the trust fund: *In re Earl of Winchelsea's Policy Trusts* (1888) 39 Ch. D. 168.

[100] In *In re Power's Policies* [1899] 1 I.R. 6, 25, FitzGibbon L.J. claimed that Fry L.J. did not mean by these words that the payments made by the mortgagee could have no higher priority than his mortgage.

The result in *Leslie* was unexceptionable. However, Fry L.J.'s *dicta* have had a restrictive effect on English law since that time.

The death warrant for the doctrine of salvage in this context was signed in *Falcke* v. *Scottish Imperial Insurance Co.*,[101] where the English Court of Appeal effectively adopted the list of Fry L.J. A mortgagor of an insurance policy had been discharged from liability after putting his assets into liquidation. He entered into an agreement with one Davis, who claimed to be the agent of the mortgagee, to purchase the mortgagee's interest. Davis then informed the mortgagor that the mortgagee would not pay the premium for the coming year. The mortgagor paid the premium on the faith of the agreement to purchase, though this transaction was never executed. There was no evidence that Davis had had authority to act on the mortgagee's behalf, or that the mortgagee had ratified his act.

Bacon V.-C. held that the mortgagor was entitled to a first lien on the proceeds of the policy in respect of the premium which he had paid. The Court of Appeal overturned this decision. Cotton L.J. made the following statement of the general law, as he saw it:

> "It is not disputed that if a stranger pays a premium on a policy that payment gives him no lien on the policy. A man by making a payment in respect of property belonging to another, if he does so without request, is not entitled to any lien or charge on that property for such payment."[102]

In this case, there was no evidence of a request by the mortgagee that the mortgagor should pay the premium. He did not believe that there had been any ratification of the payment by the mortgagee. Since the mortgagee had no knowledge of the payment by the mortgagor, the latter could not avail of any proprietary estoppel against the mortgagee.

In particular, Cotton L.J. denied that the mortgagor's interest in the policy entitled him to a lien in respect of his expenditure. Despite the fact that the mortgagor was no longer liable to pay the mortgagee, Cotton L.J. considered it "utterly wrong" to say that he could acquire any lien in priority to the mortgagee. He distinguished the earlier authorities which seemed to entertain the possibility of a salvage lien on the ground that in those cases there had been a request, express or implied, or a trustee had a

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Rather, the priority of the payments was to be determined by the rules of equity, and in effect, they should have priority over all other claims. Although this is correct by the Irish practice, it hardly seems to have been the meaning intended by Fry L.J. See also *Fetherstone* v. *Mitchell* (1848) 11 Ir. Eq. R. 35.

[101] (1886) 34 Ch. D. 234.

[102] (1886) 34 Ch. D. 234, 241.

power to make a payment, or a third party was entitled to the benefit of the trustee's power.[103] Bowen L.J. came to the same conclusion, stating that "[l]iabilities are not to be forced upon people behind their backs any more than you can confer a benefit upon a man against his will."[104] He expressly rejected the notion of rights based upon salvage in respect of land or goods upon land. The only circumstance in which a lien might be accorded to one who paid money in respect of land or goods was if it were possible to imply a contract to that effect. It was not possible to draw any such inference in this case. There was no acquiescence in the present case, and the mere fact that the owner of the equity of redemption paid a premium on the policy did not entitle him to a lien in priority to the mortgagee's claim.[105]

Fry L.J., unsurprisingly, felt that there could be no ground of a claim in "salvage." On the use of the word, he made the following insular comment:

> "I certainly wish that the expression had remained on the other side of the channel where it seems to have arisen."[106]

The only possible bases for a lien were stated to be contract or acquiescence. There was insufficient to support a finding of either in this case. The decision is a stronger one than *Leslie*, as it appears that on the Irish view, the mortgagor would have been entitled to a lien. It seems that he had an equity of redemption in the policy at the time of payment. He clearly paid to protect this interest, and the payment operated to save the policy for the benefit of all persons interested. It might also be argued that, having paid in the apparently mistaken belief that he had a contract to obtain an assignment, he should have been granted a lien by analogy with the case of purchasers at a void sale who pay off incumbrances on property or spend other money in its upkeep.[107]

The decision flies in the face of the long accepted principle that one having an interest in property is entitled to pay off a charge on the property and keep it alive for his benefit.[108] While the insurer would not have had a lien on the policy in respect of unpaid premiums, the breadth of the

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[103] His comments are unconvincing, especially those on *Gill* v. *Downing* (1874) L.R. 17 Eq. 316. See "Insurance Premiums and the Doctrine of Salvage," (1887) 31 S.J. 344.
[104] (1886) 34 Ch. D. 234, 248.
[105] The decision in *Shearman* v. *British Empire Mutual Life Assurance Co.* (1872) L.R. 14 Eq. 4 seems to be flatly contradictory, and must be taken to have been overruled.
[106] (1886) 34 Ch. D. 234, 254.
[107] *In re Sargent's Trusts* (1879) 7 L.R. Ir. 66 (purchaser of policy at void execution sale granted a lien thereon in respect of premiums he had paid); *West* v. *Reid* (1843) 2 Hare 249; *Ahmed* v. *Kendrick* [1988] 2 F.L.R. 22, 33: see section 11.8, *post*.
[108] See chapter 11, *post*.

comments of Cotton and Brett L.J. seems to exclude even this latter type of situation, and one is forced to comment that the decision was ill-considered.[109]

In *Strutt* v. *Tippett*,[110] the purchaser of an estate subject to a mortgage paid premiums on a policy of insurance which the mortgagor had covenanted to maintain. The mortgagee also held a mortgage of the policy, and was entitled to pay the premiums, if it wished, and add the sums it paid to its security. The mortgagor ceased to pay the premiums, and the mortgagee informed the purchaser that if he did not pay them, then it would enforce its security out of the estate he had purchased. The purchaser then paid a sum in respect of unpaid premiums. It was held that he had not acquired any lien through his payment. At first instance, Chitty J. held that as the case did not fall within any of the cases listed by Fry L.J. in *In re Leslie*, the purchaser could not obtain a lien. On appeal, this decision was affirmed, though the decision turned on the fact that the purchaser had obtained a covenant from the mortgagor that the latter would pay the premiums. It was felt that this express covenant excluded any right which the purchaser might otherwise have to a lien. Lindley L.J. stated that he did not think that the cases enumerated in *Leslie* were intended to represent an exhaustive list. He continued:

> "If an owner of onerous property agrees with me to indemnify me or my property from the burdens on the onerous property which may fall on me or my property, and the owner makes default, and I or my property have to bear those burdens, I am inclined to think that I should

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[109] Compare also the Irish decision in *In re Howard's Estate* (1892) 29 L.R. Ir. 266, where Monroe J. held that a mortgagor who had sold the equity of redemption and then been discharged from liability as a bankrupt, and who later purchased a mortgage on the estate, was entitled to keep the mortgage alive, as he had to be regarded as a stranger to the estate, and the principle of *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638 could not apply. American law seems to have adopted a more restrictive approach, closer to the English. L. Jones, *A Treatise on the Law of Liens* (1888), § 72, wrote: "One who voluntarily pays premiums for another, in the absence of any agreement or understanding that for such payments he should have a lien upon the policy or its proceeds, has no lien upon the proceeds collected by him as the agent of the insured." More recently, an American court has held that that a wife, the beneficiary of a policy on the husband's life, who paid premiums on it while she was the beneficiary, did not acquire any lien on the proceeds in circumstances where the husband altered the beneficiary prior to his death: *Haynes* v. *Metropolitan Life Insurance Co.*, 166 N.J. Super. 308, 319; 399 A. 2d 1010, 1015 (1979). A similar result occurred in a case where the husband had made the wife the beneficiary originally, and had told her that the policy would be hers, but later changed the beneficiary: *Smith* v. *Hinton*, 365 So. 2d 963 (Miss. 1978). In *Foskett* v. *McKeown* [1997] 3 All E.R. 392, Scott V.-C. and Hobhouse L.J. approved of the decisions in *In re Leslie* and *Falcke*. They both agreed that if an individual intentionally paid a premium on a policy belonging to someone else, there was no reason why he should thereby acquire a lien on the proceeds of the policy. Dawson, *op. cit.*, §§ 106-7, felt that the decision in *Falcke* did not rule out the acceptance of an equivalent of an action on the management of the affairs of another. Even if English law had recognised such an action, the payer would probably have failed because the payer had not paid with the intention of managing the affairs of another, but rather of protecting his own interests. This, on the other hand, would seem to have been a requirement before an Irish court would have granted relief.

[110] (1890) 62 L.T. 475, affirming (1889) 61 L.T. 460.

have, as against the owner of the onerous property, a lien on it for the money expended by me in bearing that burden which as between him and me he ought to bear."[111]

The classic Irish case on the payment of premiums by a person with an interest in the policy was *In re Power's Policies.*[112] In that case, a solicitor for the mortgagor and mortgagee of an insurance policy had taken a second mortgage to secure a loan made to the mortgagor. He paid premiums without the request of either mortgagor or first mortgagee. He later wrote to the first mortgagee, requesting that she should pay the next premiums due, but that if she could not do so, he would pay on her account. She replied, intimating that she had not assented to his payments to date, and could not pay any more premiums. The solicitor then indicated that he would pay future premiums, on the understanding that they would rank as a prior salvage lien. The first mortgagee did not reply. It was held that the solicitor had a first salvage lien for the premiums paid by him after the date of his first letter to the second mortgagee. However, he had no lien for his payments prior to that time, as the first mortgagee could reasonably have supposed that he had paid them as agent for the mortgagor. However, she had acquiesced in the later payments, which he had made in the expectation that he would be reimbursed by a prior lien, and he was therefore entitled to such a lien in respect of those payments. Apart from the ground of acquiescence, FitzGibbon L.J. stated that, it if it were necessary to do so, one could, on the facts, even imply a "request" by the first mortgagee that the solicitor should continue to pay the premiums.

FitzGibbon L.J. also stated that the solicitor's payments after the date of the first letter came within Fry L.J.'s fourth category in *In re Leslie; Leslie* v. *French,*[113] *i.e.* a case where a mortgagee pays premiums and adds them to his security. Although Fry L.J.'s comment suggested that the payments made by the mortgagee would obtain only the priority enjoyed by his existing mortgage, FitzGibbon L.J. stated that Fry L.J. had not been referring to the question of priority, which should rather be determined by the rules of equity. Just as a subsequent incumbrancer who redeemed a lease and preserved the subject matter of his security was entitled to a lien in priority to all other claims,[114] so was a mortgagee who advanced funds to preserve a policy.

4.7 Whether concurrent Wrongdoers entitled to Subrogation

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[111] (1890) 62 L.T. 475, 477. As the mortgagee was entitled to pay the premiums and add those sums to its security on the policy, and the purchaser effectively paid at the request of the mortgagee (or induced by a threat from the mortgagee), it is arguable that the purchaser should have been subrogated to the mortgagee's rights to a lien in respect of the premiums paid. In *In re McKerrell; McKerrell* v. *Gowan* (1912) 107 L.T. 404, the court imposed a lien where one part-owner of a policy paid premiums which the other part-owner had originally undertaken to pay, at the request of that other part-owner.

[112] [1899] 1 I.R. 6.

[113] (1883) 23 Ch. D. 552.

[114] *Cf. Fetherstone* v. *Mitchell* (1848) 11 Ir. Eq. R. 35, *ante.*

Some American courts have accepted that where one party which is liable for a tort has paid the victim, the payer may be subrogated to the victim's rights against other parties who are also liable. The payer may thus seek a contribution or indemnity from those parties by way of subrogation to the victim's rights. Thus, in a New Jersey case,[115] a prisoner suffered injuries arising out of the use of a swimming pool. The prisoner sued the state under a statutory tort provision. The state had incurred substantial medical expenses in caring for the prisoner. The court accepted that the state was obliged to pay those expenses independent of any tort liability it might have to the prisoner. The state claimed, *inter alia*, the reimbursement of those expenses from the manufacturer and distributor of the pool. The court held that the position of the state performing its duty to pay for the medical care of the prisoner was analogous to that of the insurer which was contractually obliged to pay medical expenses on behalf of its insured.[116] The court stated that

> "In cases in which a party undertakes to pay for an injured person's medical care, there may be a paramount or parallel legal duty on the part of another, whether by contract, statute, or equitable principles derived from the common law, to pay for those expenses ... Thus, on payment of such expenses, the payor may retain a cause of action as subrogee against a responsible tortfeasor for reimbursement of the injured person's medical expenses."[117]

At common law, there was no right of contribution or indemnity between tortfeasors in the absence of a contract to that effect.[118] Statute in many jurisdictions now regulates the law in this area. In Ireland, the Civil Liability Act 1961 creates an intricate regime governing the rights to contribution or indemnity of concurrent wrongdoers (the definition encompasses persons in breach of contract or trust, as well as tortfeasors). Those rights exist quite distinctly from any right to subrogation. It is felt that there can be no right to subrogation or contribution for tortfeasors outside that existing under the Act.[119] In *The Englishman and the Australia*,[120] it was held that, even after judgment had been given against two tortfeasors, they could not be said to be liable with each other for the payment of a debt or duty within the meaning of section 5 of the Mercantile Law Amendment Act 1856,[121] and that accordingly, one was not entitled to subrogation on paying the creditor.[122]

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[115] *Holloway* v. *State of New Jersey*, 593 A. 2d 716 (N.J. 1991).
[116] 593 A. 2d 716, 719 (N.J. 1991).
[117] 593 A. 2d 716, 719 (N.J. 1991), citing *Culver* v. *Insurance Company of North America*, 115 N.J. 451, 456; 559 A. 2d 400 (1989).
[118] *Merryweather* v. *Nixan* (1799) 8 T.R. 186; *Adamson* v. *Jarvis* (1827) 4 Bing. 66; *The Englishman and the Australia* [1895] P. 212.
[119] In *Holloway* v. *State of New Jersey*, 593 A. 2d 716 (N.J. 1991), the court accepted that the state had a right of reimbursement arising out of its obligation to pay the medical expenses, and a separate right to contribution or indemnification arising out of its putative status as a joint wrongdoer. New Jersey had a Joint Tortfeasors Contribution Law (N.J.S.A. 2A:53A-1 to -5).
[120] [1895] P. 212.
[121] 19 & 20 Vict., c. 97. On this provision, see *post*.
[122] The statute was said not to have affected the common law rules.

As against that, one must recite the view of Gannon J.:

> "as between those persons who are liable in damages to compensate the same claimant upon the same cause of action the one who discharges the liability in full is entitled in equity by subrogation to recover from the others a contribution of the proportions of what he paid commensurate with the liability of such others to the same claimants."[123]

The Supreme Court in the same case offered no view on this statement. Gannon J. was of the view that the insurer's right of contribution against another insurer was worked out by means of subrogation to the insured's rights against that other insurer. There is, however, authority to the contrary,[124] and it is felt that Gannon J.'s statement is over-broad.[125]

4.8 Payments induced by Fraud or Mistake

Cases where a payment is made through the fraud of the debtor or a mistake on the part of the payer raise identical issues where the payer makes a loan to the debtor. Therefore, these topics are postponed to a discussion of the entitlement of lenders to subrogation.

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[123] *Zurich Insurance Company* v. *Shield Insurance Company Ltd.* [1988] I.R. 174, 177.
[124] See, *e.g.*, *Sydney Turf Club* v. *Crowley* [1971] 1 N.S.W.L.R. 724, and section 2.7, *ante*.
[125] *Cf. East Cork Foods Ltd.* v. *O'Dwyer Steel Co. Ltd.* [1978] I.R. 103, where the Supreme Court held that one concurrent wrongdoer who paid a contribution to another wrongdoer, pursuant to a determination of the court, which was reversed on appeal, was entitled to recover the amount so paid from the other wrongdoer, on the ground of money paid under legal compulsion. Further, it was said that the recipient wrongdoer would hold that money as a constructive trustee for the payer.

CHAPTER 5

SUBROGATION OF LENDERS

5.1 Scope of Chapter

Where a payer pays the debtor, under an agreement that the debtor will use this money to pay a creditor, the substance of the transaction is no different from a payment by the payer directly to the creditor. The payment is made through the instrumentality of the debtor. However, this example is the simplest case. Issues may arise which do not in the case of a direct payment. For one thing, it may prove difficult to establish whether money was paid for any specific purpose. Issues of tracing are likely to arise: a payer may have difficulty in establishing that a creditor was paid by the traceable product of the money which the payer paid to the debtor. Tracing issues have already been considered in section 2.2. There are issues which are common both to cases of direct payments and loans, and these are considered in the next chapter.

5.2 Loan for the purpose of discharging an Incumbrance

A lender may expressly agree with a borrower that the borrower will use funds advanced to discharge an incumbrance, and that the lender shall be subrogated to the rights of the creditor who is so paid. The creditor paid need not assent to this subrogation for it to be effective.[1] Furthermore, the assent of creditors subsequent to him who is paid off is also irrelevant.[2] In one decision, Porter M.R. expressed the view that a lender would automatically be subrogated to the rights of a creditor whom the borrower paid off using the funds lent.[3] This does not appear to be an accurate statement of the current law. If there is no evidence that money was lent for that specific purpose, the mere fact that the money is used to purchase property or in the payment of debts will not mean that the lender will be subrogated to the rights of the vendor or creditor.[4]

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[1] *E.g.*, *McCollum* v. *Lark*, 187 Ga. 292; 200 S.E. 276 (1938), where the debtor had entered into an agreement with the lender, to which the prior creditor who was paid was not a party. The prior creditor had his judgment marked paid and satisfied, and satisfaction was entered on his execution docket. Nonetheless, the lender was held entitled to raise that prior lien as against a subsequent incumbrancer.

[2] *McCollum* v. *Lark*, 187 Ga. 292, 303; 200 S.E. 276, 283 (1938). It was also held that the fact that the lender had constructive notice of the liens of the subsequent creditors was irrelevant.

[3] *In re Lough Neagh Ship Co.; Ex parte Workman* [1895] 1 I.R. 533. At 540, Porter M.R. quoted D. 20.4.16 in support of this proposition, though he noted that it referred to cases of direct payments by a subsequent creditor to a prior one. *Cf. Wylie* v. *Carlyon* [1922] 1 Ch. 51, 63.

[4] See, *e.g.*, *McKay* v. *Green*, 3 Johns. Ch. 56, 58 *per* Kent C. (N.Y. 1817):

> "The plaintiff endorsed the note of the intestate, upon his personal credit, and there was no promise, at the time, of any real security, nor any thing in the transaction to imply one. The

However, it appears to be the case in Ireland and England that where a lender advances funds for the *purpose* of purchasing property or paying off a debt secured on property, he will *prima facie* be deemed to have intended that he should be subrogated to the position of the vendor or creditor who was paid off,[5] although there is authority in favour of the opposite presumption.[6] The subrogation has been said to be founded on the presumed "mutual" intention of the lender and borrower, and is in effect a contractual term.[7] As an implied contractual term, it is easily displaced by an inconsistent term, such as the taking of express security for the advance.[8] The disputed presumption of subrogation and the relevance of intention have already been discussed in section 1.3, and will not be revisited here. Although this presumption of intention to be subrogated is now established, nonetheless, if the court concludes that the parties intended the loan to be unsecured, it will hold that no subrogation took place.

In *Paul* v. *Speirway Ltd. (in liq.)*,[9] a lender advanced funds to a promoter of a company, in order to finance the purchase of property. The promoter had already paid the deposit. He later received the funds from the lender on behalf of the company, which did not have a bank account. A contemporaneous agreement between the lender and the majority shareholder in the company provided that the lender should be recorded as a creditor of the company, but not be entitled to interest. Oliver J. held that this comprised the "total arrangements" between the parties, and that the lender had not intended to take security. Therefore, he had not been subrogated to the vendor's rights. In the recent case of *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[10] Lord Hoffmann (with whom a majority of the House agreed) stated that he would not question the proposition that subrogation to a security would not be

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> notion that the plaintiff had an equitable *lien* upon the land, because the note he endorsed was applied in part payment of the purchase money, is entirely without foundation."

One should compare the excessively broad comment of Walton J. in *Burston Finance Ltd.* v. *Speirway Ltd. (in liq.)* [1974] 1 W.L.R. 1648, 1652:

> "What is the basis of the doctrine of subrogation? It is simply that, where A's money is used to pay off the claim of B, who is a secured creditor, A is entitled to be regarded in equity as having had an assignment to him of B's rights as a secured creditor."

[5] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 104 *per* Lord Diplock, adopted by the Irish Supreme Court in *Highland Finance (Ireland) Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1998] 2 I.R. 180, 185-7.

[6] *Wylie* v. *Carlyon* [1922] 1 Ch. 51, 63 *per* Eve J.; *De Garis* v. *Dalgety & Co., Ltd.* [1915] S.A.L.R. 102, 154 (where Buchanan T.J. stated that an express agreement was necessary before the lender could be subrogated); *Evandale Estates Pty. Ltd.* v. *Keck* [1963] V.R. 647; *Cid* v. *Cortes* (1987) 4 B.P.R. [97276] at 9393-4, Supreme Court of New South Wales, Equity Division, 1987 NSW LEXIS 7090; BC8701374, Young J., judgment delivered 13th May 1987. See also *Cumberland Building & Loan Association* v. *Sparks*, 106 F. 101, 103 (E.D. Ark. 1900); *Commonwealth Bank of Australia* v. *Horvath* (1996) A.N.Z. Conveyancing Reports 501; 1996 VIC LEXIS 1370; BC9601260.

[7] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 104 *per* Lord Diplock.

[8] *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 104 *per* Lord Diplock.

[9] [1976] 2 All E.R. 587.

available where the parties' intention had been merely to create an unsecured loan.[11] He declined to express a decided view on the incidence of the burden of proof in showing where the intention was to create an unsecured loan, though he thought it might be on the payer.[12]

In a recent Irish case, *Highland Finance (Ireland) Ltd.* v. *Sacred Heart College of Agriculture Ltd.*,[13] it was held that a lender had not intended to keep alive the vendor's lien to which it would otherwise have been subrogated. The lender advanced funds in order to enable the borrower to purchase two milk quotas. The borrower agreed to a repayment schedule under which the loans, bearing interest, would be repaid in instalments over a number of years. Some of the payments were to be made by the vendor out of an account which the borrower maintained with it. A third party also guaranteed the repayments, although the guarantees turned out to be unenforceable. A receiver had been appointed over the borrower by a debenture holder. The receiver argued successfully that the terms of the agreement were inconsistent with the simultaneous enjoyment by the lender of a lien.

In the High Court, Murphy J. stated that the lender would have been entitled to the vendor's lien unless the agreement between lender and borrower was inconsistent with the retention of the lien. He thought that the lien, being equitable, would clearly merge in a legal charge taken by the lender.[14] He felt that it was unclear whether or not the lien would merge in the equitable charge created by an agreement to grant a legal charge.[15] However, authority had established that the lien would not merge in an equitable charge created by an agreement to create an equitable charge.[16] In the present case, the provisions that the loans were to be repaid over a period of years could not be reconciled with the continued existence of a lien which could be enforced *instanter*. While there might always be a deviation between the terms of repayment of the loan and of the purchase price, the inconsistency had to be measured; if the loan were repayable in the short term, the retention of the lien might still be possible; in other cases, it would not. He

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[10] [1998] 1 All E.R. 737.
[11] [1998] 1 All E.R. 737, 747.
[12] He stated that on general principles, the onus might be on the party claiming that there had been an unjust enrichment to show what the intention had been. This statement was so expressed because Lord Hoffmann regarded intention as being material in showing whether an enrichment was unjust. See section 1.3, *ante*. Compare the formulations used by Oliver J. in *Paul* v. *Speirway Ltd. (in liq.)* [1976] Ch. 220, following *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732, 745, to the effect that if a lender's money was used in the payment of a mortgage, the lender was presumed to have meant that the mortgage should be "kept alive for his own benefit."
[13] [1998] 2 I.R. 180, affirming [1992] 1 I.R. 472.
[14] *Cf. Burston Finance Ltd.* v. *Speirway Ltd. (in liq.)* [1974] 1 W.L.R. 1648. Note also *In re South Coast Boatyard; Barbour* v. *Burke*, unreported judgment of McWilliam J., High Court, 1979 No. 280 Sp., delivered 20th November, 1979, affirmed [1980] I.L.R.M. 186 (the case was not cited to Murphy J.).
[15] On the authority of *Bank of Ireland Finance Ltd.* v. *D.J. Daly Ltd.* [1978] I.R. 79, the answer should be "No." While *Daly* concerned an agreement to create an equitable mortgage, it is submitted that there is only one type of equitable charge, and that there is no distinction between the charge which arises under an agreement to grant a legal charge and that which arises under an agreement to grant an equitable charge.
[16] *Bank of Ireland Finance Ltd.* v. *D.J. Daly Ltd.* [1978] I.R. 79.

concluded that the parties had not intended to preserve the vendor's lien. It should be noted that Murphy J. accepted that, *prima facie*, the lender was entitled to the lien. In other words, he held that subrogation had in a sense taken place, but that the lien had been abandoned.

The lender appealed against Murphy J.'s holding that the repayment terms were inconsistent with the retention of the equitable lien. The receiver did not file a cross-appeal, so the issue of whether or not the lender had *prima facie* become entitled to the vendor's lien was not before the court. Counsel for the receiver argued that subrogation was only an equitable remedy to reverse unjust enrichment. In the present case, the lender was an unsecured creditor making a "flagrant attempt ... to walk to the top of the queue" simply because it could identify the property purchased using the loan. The Supreme Court[17] in effect accepted this latter proposition, though it made no clear statement on the former. The court accepted that where a lender advanced funds for the express purpose of the purchase of property, it was "well-settled that *prima facie* he [was] entitled by subrogation to the unpaid vendor's lien on the property for the amount of the advance."[18] However, in the present case there were a number of features which rebutted the presumption that the lender had been subrogated.

First, the terms of the loan made no reference to subrogation. While this was not conclusive, it was a relevant factor in considering whether or not the lender had intended that subrogation should take place. The irrevocable authority to the co-operative to make payments to the lender was a further indication that the borrower and lender did not intend that the lender should have any security upon the milk quotas themselves. Also, the fact that the lender had obtained a guarantee from a third party (though it later turned out to be invalid) indicated that it had not desired any other security.

Blayney J. considered that on the construction of the loan agreements, the current value of future interest became immediately due to the lender. This meant that the debt owed to the lender exceeded that due to the vendor. He seemed to think that this militated against subrogation. As Murphy J. had noted, the vendor had been entitled to immediate payment of the purchase price, whereas the lender had only been entitled to payment by instalments. It may be doubted whether these last two factors should really have been taken to be strongly indicative. Some difference between the terms of the contracts of loan and sale is inevitable.[19] It is clear that the lender could only claim subrogation to the extent to which his advance was used to pay off the vendor.[20] However, there is no reason why a lender could not be subrogated to the

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[17] [1998] 2 I.R. 180.
[18] [1998] 2 I.R. 180, 187.
[19] Indeed, Blayney J. accepted the comment of Murphy J. that a degree of inconsistency between the two would not necessarily exclude subrogation.
[20] As to tracing, see section 2.2, *ante*, and as to the limitation on the amount which a subrogated party may recover, see section 3.6, *ante*.

rights of a vendor, with a saving as to certain aspects of those rights.[21] A court could have imposed conditions that the lender should only be repaid in the same instalments that he would have received under the contract of loan. The court concluded that the parties had intended the loan to be unsecured. There was no factor in the case which rendered it unjust for the lender to remain unsecured. The court therefore dismissed the lender's appeal.

The decision is clearly correct: the loan had been intended as an unsecured one. The lender should not have been allowed to improve his position merely because he could identify the property purchased with his advance. The contract between lender and borrower was effective and complete. In other words, the intention had been fulfilled. The same result would follow, *a fortiori*, on an unjust enrichment analysis. The invalidity of the guarantee from the third party and the borrower's insolvency would not appear to have amounted to a failure of consideration which would justify a holding that the lender had been subrogated to the vendor's rights: the lender got what he bargained for, a bad deal.

As was noted before, the statutory provision which is now section 84 of the Building Societies Act 1976 can operate in a manner which has an effect comparable to subrogation.[22] The effect of the section is that a receipt endorsed on a legal mortgage by a building society operates to vest the legal estate in the person for the time being entitled to the equity of redemption. Parker J. applied the predecessor of this provision[23] in *Crosbie-Hill* v. *Sayer*.[24] In that case, a mortgagor had granted a mortgage to a building society. He later arranged with a bank to pay off the mortgage. The society agreed with the bank that the latter would pay the money to the credit of the society's account, and that the society would endorse the mortgage with a receipt and would give all the deeds to the bank, save the mortgage. The bank in fact paid the money to the credit of the mortgagor's account, and the mortgagor immediately drew a cheque in favour of the society which was duly credited to the society's account. The mortgagor granted the bank an equitable charge on the property, undertaking to grant it a legal mortgage on request. The society afterwards gave the mortgage deed to the bank, endorsed with the statutory receipt. Parker J. held that the statutory receipt operated to vest the legal estate in the bank, as it was the person with the best right to call for a reconveyance of it. The fact that the mortgagor had contracted to grant a legal mortgage was not inconsistent with an intention on the part of the parties that the bank should obtain the legal mortgage in the meantime.[25]

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[21] In other cases, the courts have imposed restrictions on a lender's rights when subrogated, so that he could not enjoy more favourable rights than he had bargained for. See section 3.9, *ante*.
[22] See section 4.2.a, *ante*.
[23] Section 42 of the Building Societies Act 1874 (37 & 38 Vict., c. 42).
[24] [1908] 1 Ch. 866.
[25] The physical delivery of a mortgage deed by the mortgagee to the lender has been held to be evidence that the lender was to have the benefit of the mortgage: *Syed Mahomed Ibrahim Hossein Khan* v. *Ambika Persad Singh* (1911) L.R. 39 Ind. App. 68. In that case, it was held that the prior mortgage had not merged, and the lender was therefore entitled to priority over intermediate incumbrancers. *Cf. Watts* v.

5.3 Where the Borrower undertook to grant a Security to the Lender, but failed to do so

This category of cases concerns situations where the lender contracted to obtain security, but did not receive it. Mitchell categorises these cases as ones of failure of consideration.[26] Burrows would explain subrogation in these cases as equity's "next best thing" to the performance of the original contract.[27] In *Hooper* v. *Eyles*,[28] a guardian borrowed money to pay off an incumbrance on an infant's estate, promising to give the lender a security for it. She died before giving the security. The lender brought a claim "to have a satisfaction out of the infant's estate, his money having paid off the incumbrance that was upon it." The court refused to make such a decree, as the lender had not proved the application of the money lent to the payment of the debt.[29] Nonetheless, the lender was granted a personal remedy.

In *Bank of Ireland Finance Ltd.* v. *D.J. Daly Ltd.*,[30] a lender advanced funds to a borrower in order to finance the purchase of property. The borrower promised to deposit the title deeds with the lender by way of equitable mortgage, and to hold the deeds on trust for the lender pending the "completion" of the "transaction." The borrower acquired the property, in part using the funds lent, but failed to deposit the deeds. McMahon J. held that the lender had been subrogated to the position of the vendor, and was entitled to the benefit of its lien. McMahon J. accepted that the agreement to deliver the title deeds by way of mortgage itself created an equitable charge on the property which took effect when the borrower acquired the property.[31] He then stated that prior to the completion of the purchase, the lender had been subrogated to the vendor's lien. This statement seems rather odd, since there could have been no subrogation until the borrower actually paid the vendor. He presumably meant that, once the vendor had been paid, the lender had then been subrogated to its lien.[32]

McMahon J. further held that the vendor's lien had not merged in the equitable charge which the lender obtained once the borrower acquired the deeds. In the earlier case of *Burston Finance Ltd.* v. *Speirway Ltd. (in liquidation)*,[33] Walton J. had held that a vendor's lien had merged in a legal charge

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Symes (1851) 1 De G., M. & G. 240; *Mackenzie* v. *Gordon* (1839) 6 Cl. & F. 875, approved by Blackburne L.C. in *Walcott* v. *Condon* (1853) 3 Ir. Ch. R. 1, 14.

[26] *Op. cit.*, 141-2.

[27] *The Law of Restitution* (1993), 85-7, 89-90: see also section 3.9, *ante*.

[28] (1704) 2 Vern. 480; Eq. Ca. Abr. 262, pl. 5.

[29] See section 2.2, *ante*.

[30] [1978] I.R. 79.

[31] *Ex parte Crossfield* (1840) 3 Ir. Eq. R. 67; *Simmons* v. *Montague* [1909] 1 I.R. 87.

[32] He was following a comment of Lord Diplock in *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, to the effect that pending the execution of a legal charge, the lender might be entitled to the vendor's lien. On the execution of the charge, however, the lien would merge.

[33] [1974] 1 W.L.R. 1648.

taken by a lender.[34] McMahon J. accepted this authority, but did not feel that the equitable charge in favour of the lender was inconsistent with the retention of the lien.[35] Each was an equitable security of the same rank, and was capable of coexisting with the other. The decision can be seen as equity effecting a type of specific performance through the mechanism of subrogation: the "next best thing" approach.[36]

5.4 Where there was an Agreement for Security, but the Borrower was not the Owner

The cases under this rubric can be again be regarded as equity's approximation of the original bargain, and can be justified on a restitutionary basis on the ground of the borrower's fraud. In *Butler* v. *Rice*,[37] the borrower requested the lender to advance funds to him in order to pay off a mortgage on Blackacre, which the lender believed to have been owned by the borrower. In fact, the land was owned by the borrower's wife. Unbeknownst to the lender, the mortgage also extended to Whiteacre, also owned by the borrower's wife. It was agreed that the lender would take as security a legal mortgage on Blackacre and a guarantee by the solicitor for the borrower and his wife. The lender drew a cheque in favour of the borrower, who paid off the mortgage. The borrower's solicitor retained the deeds as stakeholder. The borrower's wife knew that the lender had advanced funds to the borrower, but was found not to have known the circumstances under which he had paid. She refused to grant a mortgage.

Counsel for the lender claimed that the mortgage had been kept alive for his benefit.[38] Warrington J. commented that he could treat the case as one of a "stranger" who paid off a mortgage without the request of the mortgagor. He found that the lender had not intended by his payment to discharge the mortgage. The concurrence of the mortgagor was irrelevant to the question whether or not the mortgage had been kept alive. The only alteration which had taken place in her position was that she now had a different creditor. The fact that the lender had bargained for and obtained security was not evidence that "he intended in the meantime to give up such security as a transfer of the deeds would give him."[39] The fact that the borrower's solicitor held the deeds as stakeholder supported this conclusion. He therefore ordered that the lender was entitled to a charge on *Blackacre only* on the same terms as the

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[34] This was even though the charge proved unenforceable against the liquidator because it had not been registered under the Companies Act. In *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, Lord Diplock expressed agreement with this decision, which was followed by McWilliam J. in *In re South Coast Boatyard; Barbour* v. *Burke*, unreported, High Court, 1979 No. 280 Sp., delivered 20th November, 1979. In *Chetwynd* v. *Allen* [1899] 1 Ch. 353, 358, Romer J. had stated that a prior valid security would not merge in an invalid later one, and one tends to think that this is the better rule.

[35] The equitable charge was unenforceable as it had not been registered under section 99 of the Companies Act 1963.

[36] *Cf.* Mitchell, *op. cit.*, 142, who thinks that specific performance would be an adequate remedy for a lender in a case such as this.

[37] [1910] 2 Ch. 277.

[38] They added the curious comment that it made no difference whether or not they were subrogated to the borrower's position, and had to claim through him ([1910] 2 Ch. 277, 281). It is hard to see how the borrower could have enjoyed any rights against his wife or her property.

mortgagee had been. Although Warrington J.'s decision was expressed to be based on the lender's intention, it is clearly sustainable also on the ground of the borrower's (and, it seems, his wife's) fraud.

The recent case of *Castle Phillips Finance* v. *Piddington*[40] is arguably an even more acute example, though the wife was here quite innocent of any wrongdoing. The wife was the sole owner of the matrimonial home. She executed a valid charge of the house to Lloyd's Bank as security for loans to her husband. The charge was registered. She later executed a further charge to Barclays Bank. The husband had informed her that this charge was to secure a loan for roof repairs. In fact, Barclays had already paid off the husband's debts to Lloyd's, and Lloyd's charge had been cancelled, and the certificate of title had been given by Lloyd's to Barclays. The charge which the wife executed in favour of Barclays in fact secured all of the husband's debts to Barclays.

The husband misapplied the funds advanced for repairs, and incurred other substantial debts to Barclays. At first instance, Judge Chalkley held that the charge to Barclays had been valid only to the extent that the wife had understood its object. In other words, the charge was valid only in so far as it had secured the advance for repairs. The Court of Appeal, however, held that the charge had been invalid *in toto*. Judge Chalkley had then held that Barclays had been subrogated to the benefit of Lloyd's charge over the property, and that the wife was thus bound by Barclays' charge to that extent also. The Court of Appeal held that Barclays had been subrogated to the benefit of Lloyd's charge, because Barclays had made the payment to the husband in the belief that they would obtain a valid security in return.

Barclays later brought proceedings against the husband to recover the amount of its loan. The husband paid Barclays by re-financing the property. He obtained a short-term loan from the plaintiff. As security, the plaintiff took a mortgage of the wife's property. The husband employed a female third party to impersonate his wife and forge her signature on (a) a transfer of the property into the joint names of the husband and wife, and (b) a legal charge of the property to the plaintiff. The plaintiff had no notice of the fraud. It drew cheques in favour of the husband and wife. The husband and the third party endorsed one of these cheques over to Barclays, which was duly paid. The plaintiff then obtained the cancellation of Barclays' charge in the Land Registry.

The husband defaulted in payment to the plaintiff. The plaintiff then sought to enforce its security. Judge Chalkley held that the security was void as against the wife. The plaintiff claimed in the alternative that it had been subrogated to the benefit of Barclays' charge. Judge Chalkley had held that save in so far as its loan had been used to pay for repairs or it had been subrogated to Lloyd's charge, *Barclays'* charge was invalid. He held that the *plaintiff* was entitled to be subrogated to Barclays' charge,

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[39] [1910] 2 Ch. 277, 283.
[40] (1994) 70 P. & C.R. 592.

in so far as *that* was valid. He awarded simple interest from the date of creation of the charge in favour of the plaintiff up to the date of trial, and ordered that the Land Certificate should be deposited with the plaintiff as security.

The wife appealed against this decision. The plaintiff relied on *Butler* v. *Rice*[41] as supporting its claim to have been subrogated to Barclays' charge in so far as that was valid. Counsel for the plaintiff referred to this doctrine as the principle of "failed substitute security." Counsel for the wife criticised *Butler* v. *Rice*[42] and other cases which applied that decision using the argument of Mitchell[43] that there should be no rule that a third party paying off a mortgage is to be presumed to have intended to have kept it alive for his benefit.[44] However, it appears that counsel for the wife also maintained that there could be no subrogation without an express or implied contract to that effect between payer and debtor (here, the wife).

However, Peter Gibson L.J. did not accept this proposition. He noted that subrogation often arose in the absence of any contract to that effect. Counsel for the wife also argued that it would be an unwarranted extension of the *Butler* v. *Rice*[45] principle if the plaintiff were to obtain the benefit of Lloyd's security by a process of successive subrogation, which he termed "sub-subrogation." Peter Gibson L.J. rejected these arguments, and in the process rejected Mitchell's view. He felt that the weight of authority left him with no option. He added that if a loss had to fall either on an innocent mortgagor or on an innocent lender, he did not consider it unjust if it were to fall on the former, as she would otherwise obtain a windfall benefit.[46]

Having concluded that Barclays' charge was invalid *in toto*, the Court of Appeal discharged Judge Chalkley's order that the plaintiff had been subrogated to Barclays' charge, and instead made an order that the plaintiff had been subrogated to Lloyd's charge, to the extent to which Lloyds had been paid by means of the advance made by Barclays. The only real distinction was that the plaintiff was held not to have been entitled to a security for the amount of Barclays' loan which the husband had applied in repairs. The plaintiff was held to be entitled to such interest on the sum validly secured as it would have been

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[41] [1910] 2 Ch. 277.
[42] [1910] 2 Ch. 277.
[43] As expressed in "The Law of Subrogation," [1992] L.M.C.L.Q. 483.
[44] *Cf. Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732, 745.
[45] [1910] 2 Ch. 277.
[46] Peter Gibson L.J. also rejected a separate argument made by counsel for the plaintiff, to the effect that the wife's limited consent to the creation of the charge in favour of Lloyd's extended also to the creation of charges in substitution for that charge (distinguishing *Bristol and West Building Society* v. *Henning* [1985] 1 W.L.R. 778 and *Equity and Law Home Loans Ltd.* v. *Prestidge* [1992] 1 W.L.R. 137).

entitled to under Lloyd's charge.[47] The Court also ordered that the register be amended to show the plaintiff as proprietor of Lloyd's charge.[48]

5.4.a Where the Borrower was not the Owner of the Property at the time of the Loan, but later acquired it

In *Whiteley* v. *Delaney*,[49] a mortgagor's daughter agreed to purchase Blackacre from the mortgagor. Blackacre was subject to a first mortgage to A., a second charge in favour of A., and a third mortgage to the plaintiff. The daughter was unaware of the existence of the plaintiff's mortgage, even though it and A.'s mortgages had been registered. The solicitor employed by the daughter located a lender. The lender advanced funds to the solicitor, who used them to pay off A.'s first mortgage. The daughter herself paid off A.'s second charge. The solicitor then obtained the title deeds from A. The lender had agreed to take a first mortgage on Blackacre. After an interval of three weeks, the parties executed two deeds: (a) a re-conveyance by A. to the mortgagor, and (b) a conveyance by the mortgagor to his daughter. The next day, the daughter executed a mortgage to the lender. The plaintiff claimed that his mortgage had priority on Blackacre. He claimed that the re-conveyance by A. to the mortgagor had caused A.'s mortgage to become merged in the equity of redemption, and that his own mortgage therefore ranked as the first security.

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[47] Peter Gibson L.J. stated that it was clear from the decision in *Western Trust & Savings Ltd.* v. *Rock* [1993] N.P.C. 89 that "a person entitled to subrogation steps into the shoes of the secured creditor for all purposes, including interest." As the rate of interest under the Lloyd's charge was almost certainly less than that reserved by the plaintiff's own charge, the decision is unobjectionable on this point, though the judge's comments are rather broad. *Cf.* section 3.9, *ante*. The decision in *Western Trust & Savings* was that a mortgagee who had been subrogated to the benefit of an earlier mortgage had also been subrogated to the earlier mortgagee's right to claim compound interest. This is unobjectionable provided that the later mortgage also provided for compound interest at a similar or higher rate. *Cf. Cradock* v. *Piper* (1846) 15 Sim. 301 and *Chetwynd* v. *Allen* [1899] 1 Ch. 353.

[48] One may note here the case of *O'Keeffe* v. *Russell* [1994] 1 I.L.R.M. 137, noted [1994] Rest. L. Rev. § 181, in which the Supreme Court declined to consider whether or not a lender had been subrogated to the vendor's lien over the interest of one joint purchaser of land, against whom it did not have a valid security. The point had not been pleaded nor, it seemed, argued before the High Court. The lender had agreed to advance funds to a husband and wife so that they might buy land as joint tenants. As security, it agreed to accept a deposit of the Land Certificate of the lands. The wife only agreed to the granting of this security on condition that the loan was made to her husband and herself and that certain other conditions were met. The loan was in fact only made to her husband. Costello J. and the Supreme Court held that, as the lender had not fulfilled the conditions under which the wife had agreed to grant the security, it could only attach to the husband's interest. Even if the Supreme Court had considered the question of subrogation, it seems that the lender must have failed on the ground that it had in effect elected by its acts to take security from the husband alone. This seems to be a factor which would rebut the presumption that the lender meant to preserve the vendor's lien for his own benefit. *Cf.* Doyle, "Reason and Justice in the Law of Subrogation," (1994) 12 I.L.T. 10, 12-3. It should be noted that the result of the decision, both as the Court held, and as considered here, was that the wife obtained an unincumbered interest as joint tenant, though she had not paid a commensurate share of the purchase price. Doyle observes (at 13) that "[h]ad the bank [the lender] succeeded in a subrogation claim it would have obtained a benefit it had not bargained for."

[49] [1914] A.C. 132, reversing *Manks* v. *Whiteley* [1912] 1 Ch. 735, reversing [1911] 2 Ch. 448.

The House of Lords held that the mortgage to the lender had priority over that to the plaintiff. The judgments delivered turned mainly on the real intentions of the parties to the transaction, and on their entitlement to rectification of the deeds. Viscount Haldane L.C. held that the parties had intended that the lender should have a first mortgage on the land. All the parties to the deeds, save the mortgagor, had acted under a common mistake to the effect that A.'s two incumbrances were the only ones affecting the property. On this ground, the daughter and the lender would have been entitled to have the deeds rectified by a court of equity to give effect to the intended transaction. To put matters another way, the mortgage had been transferred to the mortgagor, who had taken it as trustee for the lender. The mortgagor could not have claimed that he had destroyed the mortgage, as this would have been a breach of trust. No one who claimed through him could claim to be in any better position. As regards the lender, the plaintiff had to be regarded as a volunteer who had given no consideration for the *new* priority which he was claiming.

Lord Dunedin held similarly. He felt that the solicitor had acquired the deeds in order to assure a security to the lender, and that the effect of this was that, in equity, the lender stood in the place of A., and could have compelled a transfer of A.'s mortgage. He also felt that the lender would have been entitled to rectification. Finally, he added this gloss:

> "Where by appropriate conveyancing the charge could be preserved ... then it will be for the party alleging the charge to be dead to shew an intention to that effect. What have been called the presumptions arising from the continued existence of the charge being to the benefit of the person who has paid it off, as, *e.g.*, in the case of payment by a limited owner, are just, I think, other ways of expressing the same rule."[50]

The decision turned on the intentions of the daughter and the lender.

5.5 Where the Borrower undertakes to grant a Security, but fails to acquire an interest in the Property although the Funds are nonetheless used to discharge an Incumbrance on the Property

This type of case can again perhaps be explained as equity attempting to secure the closest result to the intended bargain. An example is *Boscawen* v. *Bajwa*,[51] where the lender advanced funds to the solicitor for an intended purchaser. The loan was to be secured by a legal mortgage on the property to be purchased. The purchaser's solicitors paid the money to the vendor's solicitors, who then transferred the funds to pay off the holder of an existing mortgage on the property. Having held that the lender could

[50] [1914] A.C. 132, 151-2. This case was followed and applied in *Ferguson* v. *Zinn* [1933] 1 D.L.R. 300.
[51] [1995] 4 All E.R. 769.

demonstrate satisfactorily that its advance had been used to discharge the mortgage,[52] Millett L.J. then considered whether or not the lender could establish that it had been subrogated. He held that it was not necessary for the lender to show that its money had been intended to be used to discharge the mortgage, or that it had intended to obtain the benefit of the mortgage by subrogation. The lender had not intended to be an unsecured creditor. It had intended to retain the beneficial interest in its *money* until it was granted a legal mortgage on the property. Its beneficial interest in the money could no longer be restored to it. If it was subrogated to the mortgage, its position would not have been improved beyond its initial position, nor would the owner's position have been adversely affected. The lender here had advanced money on trust for a purpose which failed; it was unquestionably proper to allow it to claim the traceable product of the trust money. The decision can possibly be regarded as the exercise of a continuing right of property traced into a substitute or alternatively a restitutionary remedy where the payer had a continuing proprietary base. Mitchell identifies failure of consideration as being the relevant unjust factor.[53]

Millett L.J. also stated, in passing, that if the sale had been completed and the purchaser had not executed the mortgage, the lender would have been subrogated to the unpaid vendor's lien. This seems justifiable on the traditional ground that the lender had not intended to make an unsecured loan, and should not have been prejudiced by the borrower's failure to execute a security.[54]

5.6 Where the Borrower grants a Security which fails

In *In re Burke's Estate*,[55] it appeared that a lender had advanced funds to a borrower in order that the latter might purchase a leasehold interest. The borrower deposited the agreement for a lease or

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[52] See section 2.2, *ante*.

[53] Mitchell, "Subrogation, Tracing, and the *Quistclose* Principle," [1995] L.M.C.L.Q. 451, 456. *Dicta* of Millett J., as he then was, in *Hillel* v. *Christoforides* (1991) 63 P. & C.R. 301, 307, foreshadow the decision in *Boscawen*, on very similar facts. See also *Chohan* v. *Saggar* [1992] B.C.C. 750, 756 (appeal allowed on other issues [1994] 1 B.C.L.C. 706). Another decision with an analogous fact pattern was *Penn* v. *Bristol and West Building Society* [1995] 2 F.L.R. 938, where a husband and wife were joint tenants of property subject to a mortgage to a building society. Unknown to the wife, the husband entered into a collusive transaction with a third party, the purchaser, in whose favour he executed a conveyance of the property. He forged the wife's signature to this document, with the knowledge of the purchaser. The purchaser obtained a loan from the defendant building society, the amount of which was paid to the husband as the purchase price. He applied part of these funds to pay off the original mortgage on the property. It was held that the conveyance was void as a forgery. The result was that the joint tenancy had not been severed, and no interest had passed to the purchaser, or to the building society. However, since the funds advanced by the defendant had been applied, indirectly, to pay off the existing mortgage on the property, the defendant had been subrogated to the rights of the original mortgagee. Similar decisions were *Hecimovic* v. *Schembri*, unreported, Supreme Court of New South Wales, 28th June, 1974, cited in Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 916, *Bowers* v. *Bowers*, unreported, High Court, England and Wales, Hoffmann J., judgment delivered 3rd February, 1987, and *Rogers* v. *Resi-Statewide Corporation Ltd.* (1991) 105 A.L.R. 145; 32 F.C.R. 344, which is even more similar to *Penn*.

[54] Millett L.J. had been counsel in *Burston Finance Ltd.* v. *Speirway Ltd. (in liq.)* [1974] 1 W.L.R. 1648.

[55] (1880) 7 L.R. Ir. 57.

purchase with the lender by way of equitable mortgage. This transaction was unregistrable. The borrower later executed a settlement of his interest in the premises for valuable consideration. The settlement was registered. The borrower later acquired the legal title to the premises in pursuance of his agreement. It was held that the trustee of the settlement had priority over the interest of the lender. The interest of a *bona fide* purchaser under a registered instrument had to defeat the interest of a person who claimed under an unregistrable transaction. However, in so far as the funds advanced by the lender were used by the borrower to purchase the premises, the lender had an equitable lien on the premises in priority to the trustee of the settlement.[56]

Another example is provided by the case of *In re Connolly Brothers, Ltd. (No. 2).*[57] In that case, a company had granted a floating charge over all of its property, future and present. The debentures contained a "negative pledge" by the company, to the effect that it would not create any mortgage or charge having priority over the floating charge. The company later borrowed money in order to purchase property. It agreed to grant the lender a charge upon the property to be purchased. The same solicitor acted for the company and the lender. At the completion of the sale, he took the deeds on the lender's behalf. The company then executed a charge of the property in favour of the lender. At first instance, Warrington J. held that the lender had been subrogated to the benefit of the unpaid vendor's lien. He also held that the real intention of the parties had been that the company should not acquire an unincumbered interest in the property. The Court of Appeal also held that the lender's charge had priority over the earlier fixed charge. The court did not refer to subrogation, giving as a reason for its decision that the parties' intention had been that the company should only acquire the equity of redemption in the property.[58]

One should also note here the case of *Portsea Island Building Society* v. *Barclay.*[59] In that case, a building society had exhausted its borrowing powers. It attempted to circumvent this difficulty by adopting the following procedure: an insurance company (the "lender") advanced a sum to a debtor of the society. The society held a mortgage over property of the debtor. The debtor granted a mortgage over the same property to the lender, the society joining in the conveyance for the purpose of postponing its security. This act was outside the powers of the society. The debtor then paid the society a sum equal to

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[56] (1880) 7 L.R. Ir. 57, 66 *per* Flanagan J. The point is made as if in passing.

[57] [1912] 2 Ch. 25.

[58] A security such as that given to the lender in this case is sometimes known as a "purchase money security interest," and the lender's right to priority has sometimes been defeated on the ground that for a "spark of time," (*scintilla temporis*) the unincumbered interest had vested in the company, and hence become burdened with the prior charge. See *Abbey National Building Society* v. *Cann* [1991] 1 A.C. 56, where the House of Lords disapproved of this doctrine, and R.M. Goode, *Legal Problems of Credit and Security* (2nd ed., 1988), 98-101. It should also be noted that a company which has charged all of its assets by a floating charge retains the authority to deal with them, in spite of a negative pledge. Therefore, the later fixed charge might obtain priority anyway. *Cf. Highland Finance (Ireland) Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1998] 2 I.R. 180, 192, and Goode, *op. cit.*, 84-6; P. Ussher, *Company Law in Ireland* (1986) 423-9.

[59] [1895] 2 Ch. 298, affirming [1894] 3 Ch. 86.

the amount which the lender had paid it. The result of the transaction was that the lender had given a sum of money which the society had received *via* the debtor. The society was therefore in substance a borrower.

The Court of Appeal held that the society had not effectively postponed its mortgage, as it did not have the power to do so. The result was that the lender's security ranked after that of the society. The lender then argued that it had been subrogated to the society's rights against the debtor. The court unanimously rejected this argument on the ground that the lender had paid the money to the debtor, not to the society. The decision is a curious one, and the reasoning is unclear. Lindley L.J. said that the lender could have no rights as he had not lent to the society (though this was the substance of what occurred). Lopes L.J. agreed. He also stated that the lender's contract was inconsistent with obtaining a right against the debtor which ranked *pari passu* with the society.

In both of these judgments, and especially in the third judgment, of Kay L.J., there seems to be a misconception that the lender was claiming to have been subrogated to the rights of a creditor against the society. In fact, the only intelligible interpretation of the claim is that the lender was claiming to have been subrogated to the rights of the society against the debtor. The Court of Appeal does not appear properly to have considered this issue. It would appear that, *prima facie*, the lender had a valid claim to have been subrogated to the society's rights. This is subject to two qualifications: first, the possible application of the rule against subrogation in cases of part payment;[60] secondly, the possible difficulty in claiming subrogation where an advance has been applied to the credit of an account in debit (as in the case of an overdrawn current account).[61]

In one case, a lender's security was defeated by an earlier security of which he could not have known. In *Parkash* v. *Irani Finance Ltd.*,[62] a purchaser paid the purchase price of land and was granted what he believed to be a first legal mortgage on it to a lender. The vendor discharged a charge on the land at the time of completion. Unbeknownst to the purchaser, there was a second charge on the land, the existence of which the land registry had negligently failed to disclose. Plowman J. held that in the absence of evidence that the vendor had applied the money advanced by the lender in paying the prior charge, rather than his own money, the lender could not claim that the prior charge had been "kept alive" for its benefit.[63] But for that difficulty of proof, it appears that the lender might have succeeded.[64]

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[60] See section 2.3, *ante*.
[61] See section 2.2.a, *ante*.
[62] [1970] Ch. 101.
[63] The debtor could not keep a charge alive for his own benefit by paying it: *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638.
[64] See also *Clute* v. *Emmerich*, 99 N.Y. 342; 2 N.E. 6 (1885), where a judgment was registered as a valid lien against property of the debtor which was subject to an existing mortgage, though the judgment was registered against the debtor using his middle initial. It appears that this prevented persons who conducted

5.7 Where a Borrower did not have Power or Authority to borrow

Some of the oldest reported applications of subrogation occurred in cases where a lender paid money to a person under an incapacity, such as a married woman or an infant.[65] The contract of loan was void. Sums paid under such a contract could not be recovered at law.[66] However, since the early eighteenth century at least, equity held that, to the extent to which the money was applied in the payment of creditors with valid or enforceable claims against the borrower (generally in respect of necessities), the payer was subrogated to the rights of those creditors.[67] A similar result was achieved in a case where a borrower was of unsound mind.[68] The widest application has been in cases of borrowings by unauthorised agents and by companies lacking the capacity to borrow. These categories will now be considered.

5.7.a Loan to Agent without Authority to borrow on behalf of his Principal

In a case where an agent borrows funds on behalf of his principal, but without authority to do so, and uses the funds which he receives to pay creditors of the principal, the lender will often be allowed to recover his advance from the principal on the ground that the latter has ratified the payment. In *Reid* v. *Rigby & Co.*,[69] the manager of a firm borrowed money without the authority of his firm. He informed the lender that he desired the money in order to pay the firm's employees. The Queen's Bench Divisional Court held that the lender was entitled to recover the amount of the loan from the firm as money had and

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a search against the debtor without using his initial from detecting the judgment. The debtor sold the land on, subject to the mortgage, the purchaser assuming the payment of the mortgage, without any notice of the judgment lien. The purchaser then paid off the mortgage, partly using her own funds, and partly using funds advanced by a lender, to whom she granted what was thought to be a first mortgage. The property was sold on subject to this mortgage, which was in turn paid off, a new mortgage being granted. A number of similar re-financing transactions occurred, each of which was carried out in ignorance of the judgment lien. It was duly held that the final such mortgage had priority over the judgment, the successive mortgagees each having been subrogated in turn to the position of the orginal mortgagee. Further, in so far as the final purchaser had paid off part of the last mortgage, he was also subrogated to the mortgagee's priority *as against the* judgment creditor (but not, of course, as against the mortgagee). Note also *In re Kelly's Carpetdrome Ltd.; Byrne* v. *U.D.T. Bank Ltd.* [1984] I.L.R.M. 418, where a purchase money mortgage was defeated by a prior claim, registered as a *lis pendens* (the prior claim being, at least in part, also in respect of a part of the purchase price). Although the lender claimed to have been subrogated as an alternative claim, Costello J. did not find it necessary to consider the point, as he held that the lender had acquired a valid mortgage, which still had to be subject to the resulting trust interest which had been registered as a *lis pendens*.

[65] See section 1.5, *ante*.

[66] *Cf. Cheyne* v. *Abbot of Ychefelde* (1374) C.P. 40/453 m. 212, cited by Ibbetson, "Unjust Enrichment in England before 1600," in E.J.H. Schrage (ed.), *Unjust Enrichment, The Comparative History of the Law of Restitution* (Comparative Studies in Continental and Anglo-American Legal History, Band 15, Berlin, Duncker & Humblot, 1995), at 121, 143: a lender to a monk, who was regarded as incapable of contracting, claimed, in an action against the *prior* of the monastery, that the money paid had been used to pay for repairs to the abbey and food for the monks.

[67] *Harris* v. *Lee* (1718) 1 P. Wms. 482; *Marlow* v. *Pitfeild* (1719) 1 P. Wms. 558; *Jenner* v. *Morris* (1861) 3 De G., F. & J. 45.

[68] *In re Beavan* [1912] 1 Ch. 196.

received to his use. The reason given was that the money had found its way into the firm's account, and had been used to pay employees. This was equivalent to a ratification of the payment by the firm.[70]

In other cases, practically the same result has been reached by holding that the lender has been subrogated to the position of creditors of the principal who were paid by means of the funds advanced. One of the earliest cases is that of the *German Mining Company*.[71] In that case, the directors of an unincorporated company advanced funds to the company, although it had exhausted its power to borrow. The funds were used to pay off creditors. Turner L.J. held that the directors were entitled to credit these sums against their indebtedness to the company. He seems to have based his decision on the factors (a) that the payments benefited all members; (b) the directors may have had implied authority to pay the debts; and (c) the directors, being in the position of trustees for the company,[72] had a right of indemnity from it for expenses incurred in running the company. On the basis of this latter right, they could claim the amount which they had used in payment of the company's debts. Knight Bruce L.J., however, cautioned that the same right might not be available to a stranger who advanced funds to the company. This qualification has not been accepted in later cases.

In *Bannatyne* v. *D. & C. MacIver*,[73] the agent borrowed without authority, and used the funds to pay off certain creditors of his principal. The lender had been unaware of the borrower's lack of authority. It was held that the lender could recover so much of the advance as had been paid to the principal's creditors. The court did not treat the case as one of subrogation, but as a sort of equitable ratification of the borrowings through the use of the money to pay creditors. In *Reversion Fund and Insurance Co., Ltd.* v. *Maison Cosway Ltd.*,[74] it was held that a lender to an unauthorised agent was equally entitled to recover if he knew of the agent's lack of authority at the time of making the advance. The reasoning of Buckley L.J. was that there had been in substance no borrowing; one debt owed to the creditor had merely been replaced by another owed to the lender.

5.7.b Loan to a Corporation outside or in excess of its borrowing Powers

In the nineteenth century, this was a classic case for the application of subrogation, though its practical importance has declined with statutory modifications of the effect of the *ultra vires* rule.[75] The

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[69] [1894] 2 Q.B. 40.
[70] See Birks, "Misdirected funds: restitution from the recipient," [1989] L.M.C.L.Q. 296, 307.
[71] *Ex parte Chippendale; In re the German Mining Co.* (1854) 4 De G., M. & G. 19.
[72] Nowadays, one would say that they occupied a fiduciary position with respect to the company.
[73] [1906] 1 K.B. 103.
[74] [1913] 1 K.B. 364.
[75] Section 8 of the Companies Act 1963 and Regulation 6 of the European Communities (Companies) Regulations 1973 (S.I. 163 of 1973).

lender could claim to have been subrogated to the claims of creditors who had been paid by means of the funds which it had advanced.

The earliest case is one of an unincorporated company, the *German Mining Company*, considered in the last section.[76] Later cases repeatedly affirmed the availability of the equity. In *Baker's Case*,[77] a director lent funds to a company under a contract which had not been approved by the company, and was therefore unenforceable. However, Sir Richard Kindersley V.-C. stated that the director could still recover so much of his advance as he could show to have been "duly applied in carrying on the business of the company."[78] A similar decision was given in *Troup's Case*,[79] where a director had advanced funds to the company to help purchase property, which was later sold to the company's advantage. Sir Samuel Romilly M.R. held that "if the money has been *bonâ fide* applied to the purposes of the Company, the *bonâ fide* lender is entitled to payment as against the Company."[80]

The earliest Irish case in point is *Ulster Railway Co.* v. *Banbridge, Lisburn, and Belfast Railway Co.*[81] In that case, the company had exhausted its borrowing powers. Directors procured an advance by a bank to the company. The company applied the moneys in paying contractors and other creditors. The directors then paid the bank. Counsel for the directors stated that their claim was in effect one to make the members contribute to a "salvage advance," made by the directors, without which the members would have obtained no benefit from their shares.[82] They also argued that the court should indemnify the directors "[a]s trustees *bonâ fide* exercising their discretion." Walsh M.R. felt that the situation was equivalent to one where the directors had made an advance out of their own funds. On the strength of the *German Mining Company's Case* and *Troup's Case*, he felt that the directors were entitled to be reimbursed the amount which they had advanced to meet the necessary out-goings of the company. He seemed to base his decision on the belief that they were in substance trustees for the company. Although he held that they were entitled to reimbursement, he did not state that they "stood in the place of" the company's creditors.

A security given by a borrower to secure an invalid loan has been held to have been validated to the extent to which it was used in the payment of the borrower's creditors. In *In re Bagnalstown and Wexford Railway Co.*,[83] a member advanced moneys to a company, the borrowing powers of which had not yet become operative. When its borrowing powers arose, the company issued debentures in favour of

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[76] *Ex parte Chippendale; In re the German Mining Co.* (1854) 4 De G., M. & G. 19.
[77] *In re National Patent Steam Fuel Co.; Baker's Case* (1860) 1 Dr. & Sm. 55.
[78] (1860) 1 Dr. & Sm. 55, 66.
[79] *Troup's Case; In re The Electric Telegraph Company of Ireland* (1860) 29 Beav. 353.
[80] (1860) 29 Beav. 353, 357. See also *In re Norwich Equitable Fire Insurance Company; Brosnett's Case* (1884) 54 L.J. Ch. 227, 228 *per* Bacon V.-C.
[81] (1868) I.R. 2 Eq. 190; 18 L.T. 91; 16 W.R. 598.
[82] (1868) I.R. 2 Eq. 190, 195. As to salvage, see section 4.6, *ante*.

the member. It appears that the member made a number of advances directly to the company's creditors. The Court of Appeal in Chancery held that the debentures issued to the lender were valid to the extent of the sum which had been advanced. Lord O'Hagan L.C. stated that "it would be against all notions of reason and fair play, that the company should not be made to answer for the benefits they actually enjoy."[84] Christian L.J. agreed, though he expressed a reservation as to whether a lender who was a stranger to the company could enjoy an equivalent right.[85] Later cases have acknowledged that the right is not restricted to directors or other persons associated with the company.[86]

The English Court of Appeal reached a similar decision in *Blackburn Building Society* v. *Cunliffe, Brooks, & Co.*[87] A building society had overdrawn its bank account, although it did not have the power to borrow. Certain members had deposited deeds with the bank, and officers of the society executed a memorandum in which they stated that the deeds had been lodged as security for any sum due from the society to the bank. The Court of Appeal held that the bank was entitled to hold the deeds as security for such part of the moneys advanced by it as had been applied in paying the debts of the society.[88]

In *In re Wrexham, Mold & Connah's Quay Railway Co.*,[89] the Court of Appeal held that a lender under a supposedly invalid loan contract had not been subrogated to the benefit of a security held by a creditor who had been paid off using the funds advanced. The members of the Court of Appeal all made comments to the effect that the lender's right was not an application of subrogation,[90] and that the lender could never obtain the benefit of securities held by creditors who had been paid using the funds he had advanced.[91] It is felt that these comments are wrong in both respects. Rigby L.J. said that the courts had never acknowledged a right of subrogation to the "securities or priorities" of creditors paid off using funds borrowed in excess of powers, stating that

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[83] (1870) I.R. 4 Eq. 505, overruling (1870) I.R. 4 Eq. 172.
[84] (1870) I.R. 4 Eq. 505, 519, referring to *Troup's Case; In re The Electric Telegraph Company of Ireland* (1860) 29 Beav. 353 and *In re Cork and Youghal Railway Co.* (1869) L.R. 4 Ch. 748.
[85] In this comment, he echoed Knight Bruce L.J. in the *German Mining Company's Case* (1854) 4 De G., M. & G. 19, 35.
[86] See, *e.g.*, *In re Wrexham, Mold & Connah's Quay Railway Co.* [1899] 1 Ch. 440. Compare, however, *In re Lough Neagh Ship Co.; Ex parte Workman* [1895] 1 I.R. 533, 540 *per* Porter M.R.: "[The present] is the case of a person interested in the affairs of the Company, discharging, with the privity and consent of the Company, a liability of the latter by payment."
[87] (1882) 22 Ch. D. 61.
[88] See further proceedings reported at (1885) 29 Ch. D. 902, 911.
[89] [1898] 2 Ch. 663, reheard [1899] 1 Ch. 205, affirmed [1899] 1 Ch. 440.
[90] The case was cited as authority for this proposition by Romer L.J. in *Bannatyne* v. *D. & C. MacIver* [1906] 1 K.B. 103, 109.
[91] The case was cited as authority for this proposition by Buckley L.J. in *In re Birkbeck Permanent Benefit Building Society* [1912] 2 Ch. 183, 232. See also *Wylie* v. *Carlyon* [1922] 1 Ch. 51, 63 *per* Eve J.

> "the great preponderance of authority shews that the doctrine of subrogation has very little, if anything at all, to do with the equity really enforced in the cases, and that there is, at any rate, no authority for subrogation to the securities or priorities of the creditors paid off."[92]

Vaughan Williams L.J. stated that a lender under an invalid contract of loan whose funds had been used to pay off valid debts should be able to sue the borrower directly.[93] However, the lender could not be regarded as in any manner the assignee of the creditors who were paid off. There was no previous case where a lender had been held to be entitled to enforce the securities of creditors paid off using the funds advanced. He made the further odd comment that he had "assumed" that in the circumstances of the case, there had been no borrowing in excess of the company's powers. If, however, he was wrong in that, the lender would still have an equity to have the loan treated as valid in so far as it had been applied in the discharge of valid debts.

The reason why the judges in that case stated that the lender's right was not one of subrogation was an assumption that if a payer was subrogated, he had to succeed to *all* the rights of the creditor who had been paid, including securities. The previous cases of invalid loans to companies had either concerned subrogation to personal rights or the validation *pro tanto* of a security which had been taken. However, it has long been clear, even before the *Parc (Battersea)* case, that a payer may be held to have succeeded to some only of a creditor's rights.[94] This is illustrated by the slightly earlier Irish case of *In re Lough Neagh Ship Co.; Ex parte Workman.*[95] In that case, the firm of a director of a company advanced funds to the company to enable it to purchase a ship. The company had no power to borrow the money. The funds lent were applied to pay the purchase price of the ship. Porter M.R. held that the vendors had enjoyed a lien on the ship. The lender did not claim to have been subrogated to the benefit of this lien, merely to the vendor's personal claim. Porter M.R. held that the lender had been so subrogated. Although the lender had reserved a higher rate of interest under its own contract, it was only entitled to claim interest at the rate applicable under the vendors' contract.

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[92] [1899] 1 Ch. 440, 455. He continued: "Dealing with this case independently of the authorities, I see no reason why the parties to an illegal lending should have anything more then bare justice dealt out to them."

[93] *Cf.* C. Mitchell, *The Law of Subrogation* (1994), 153: "it can be argued on two quite different grounds that reviving subrogation was not needed in these cases and that S [the lender] should have been allowed to bring a direct action against PL [the borrower]." The two grounds were: (a) that the lender should have been allowed to recover the value received by the borrower in a restitutionary action on policy grounds, or (b) the lender should be allowed to bring a direct claim against the borrower for the "value surviving" in the borrower's hands in the form of the discharge of his obligations to creditors. However, this does not seem to represent the current law.

[94] *Cf.* Goff and Jones, *op. cit.*, 169. See section 3.9 *ante*.

[95] [1895] 1 I.R. 533.

The most recent Irish decision was *In re M.J. Cummins Ltd. (in vol. liq.); Barton* v. *Bank of Ireland.*[96] In that case, a lender advanced funds to the company for a purpose which it knew to be *ultra vires*, namely, financing the purchase of the company's own shares. Johnston J. held that the loan was void, as it was made for a purpose beyond the powers of the company. If the funds were applied solely for that purpose, it is hard to see to what the lender could have claimed to have been subrogated. However, Johnston J. went on to make a rather odd comment about the application of subrogation, stating that it could not "possibly be brought into operation in a contest between the genuine creditors of a company and a person who had lent money to the company under an arrangement that was 'illegal and therefore wholly void.'"[97] If this statement were true, a lender under a contract beyond the powers of the borrower would never be entitled to reimbursement where the borrower had other creditors as yet unpaid. This would mean in effect that the lender's right would not be one of subrogation, as he would not obtain the rights of the creditors who had been paid with the funds he had advanced.

Birks[98] has expressed the view that to allow a personal action for restitution measured by the amount which the defendant received beyond its powers would amount to indirect enforcement of an *ultra vires* contract.[99] However, he felt that this objection did not apply if the plaintiff were limited to claiming the amount of the "value surviving" in the defendant's hands, including value surviving through the discharge of liabilities of the defendant, and he felt that this was the proper meaning of the subrogation cases.[100]

5.8 Where the Lender who receives a valid Security is nonetheless subrogated to a prior Security

There exist some cases where a lender who received a valid security was nonetheless held to have been subrogated to the benefit of a prior security which was discharged using funds advanced by the lender. Although it might be a term of the loan agreement that the lender should have the benefit of an existing security as well as a new one to be granted by the borrower, such cases must be rare. In an American case,[101] a creditor held a mortgage over property owned by the deceased mortgagor. After the death of the mortgagor, his widow agreed to grant and granted a mortgage of her unassigned dower interest in the estate, in return for funds advanced by the same mortgagee. The widow applied the greater part of the funds so advanced in payment of the mortgagee's earlier mortgage. The mortgagee had this marked "paid" and sent to its solicitor for cancellation. However, this mortgage was never cancelled of record. On the death of the widow, the security which she had granted over her share of the estate was extinguished. The mortgagee claimed to have been subrogated to the benefit of the earlier mortgage which

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[96] [1939] I.R. 60.
[97] [1939] I.R. 60, 72.
[98] *An Introduction to the Law of Restitution* (1985, rev. ed. 1989), 374-5.
[99] This would be by an action for money had and received by the defendant to the plaintiff's use.
[100] *Op. cit.*, 372-5.

it itself had held over the estate. Its claim was upheld. The decision seems wrong, as the lender had clearly received what it had bargained for. Even if the widow could be said to have intended to keep the earlier mortgage alive for her own benefit, it could hardly have been impliedly transferred to the mortgagee after payment by the widow.[102]

Contrariwise, in one case, a mortgagee registered a mortgage which bore the forged signatures of two of the three purported mortgagors. Under the relevant legislation, this mortgage was held to be valid and subsisting because of the registration. The owners whose signatures had been forged claimed that the mortgagee had nonetheless been subrogated to the rights of a prior mortgagee whose valid mortgage, securing a lesser sum, had been paid off with the funds advanced by the mortgagee. The result, it was argued, was that the mortgagee could only enforce his registered mortgage for that lesser sum. Hayne J. rejected this argument, holding, correctly, it is felt, that the existence of an enforceable mortgage precluded any issue of subrogation from arising.[103]

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[101] *Elmora and West End Building and Loan Association* v. *Dancy*, 155 A. 796 (N.J. Ch. 1931).
[102] See Note, "Subrogation - Subrogation of one Lending Money on Valid Security to Rights under Incumbrance satisfied with Proceeds of the Loan," (1931) 45 Harv. L. Rev. 390-1.
[103] *Vassos* v. *State Bank of South Australia* [1993] 2 V.R. 316.

CHAPTER 6

CASES OF PAYERS OR LENDERS WHO PAY UNDER FRAUD OR MISTAKE

6.1 Payment induced by Fraud

It appears that one who is induced by fraud to pay the debt of another cannot be characterised as a volunteer.[1] So, where a party advances funds to co-owners, and obtains a purportedly valid deed of mortgage or purchase, which transpires to bear a forged signature and therefore to be void, the lender or purchaser is often held to have been subrogated to the rights of any incumbrancers who were paid using the funds he advanced.[2] Where a bank paid a forged cheque for the payment of a local authority charge, which was a lien on land, it was held to have been subrogated to the local authority's rights against the land.[3] Again, where a borrower misrepresented the nature of his interest, and granted an invalid security, a lender was held to have been subrogated to the rights of prior incumbrancers paid off using the funds which it had advanced.[4] Similarly, in *Wilson* v. *Kimble*,[5] a purchaser had assumed the payment of a mortgage on property, which he paid in due course. Unbeknownst to the purchaser, a second, subsequent mortgage existed on the property. The benefit of this mortgage had been assigned to a third party by the mortgagee. The vendor of the property had lied to the purchaser, telling him that this second mortgage had been paid and satisfied and that the deed was now lost. The original mortgagee of this mortgage later recorded a purported discharge in the registry of deeds. The purchaser had also been given what purported to be a promissory note of the vendor, in respect of the second mortgage debt. The assignee of the second mortgage had been oblivious of these matters. He now sought to foreclose his mortgage, claiming that, as the purchaser had discharged the first mortgage, he now stood as the first mortgagee of the property. The court held that the purchaser was entitled to the benefit of the first mortgage, in order to protect himself against the assignee of the second mortgage. Since the purchaser had clearly not undertaken to pay the

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[1] For the position in the United States, see the *Restatement of Restitution* (1937), § 146 g., illustration 8; *Eastern States Petroleum Co., Inc.* v. *Universal Oil Products Co.*, 44 A. 2d 11, 15 (Del. Ch. 1945).
[2] *Hecimovic* v. *Schembri*, unreported, Supreme Court of New South Wales, 28th June, 1974, cited in Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 916; *Rogers* v. *Resi-Statewide Corporation Ltd.* (1991) 105 A.L.R. 145; 32 F.C.R. 344; *National Guardian Mortgage Corporation* v. *Roberts* [1993] N.P.C. 149; *Western Trust & Savings Ltd.* v. *Rock* [1993] N.P.C. 89; [1993] C.L.Y. § 2883; *Castle Phillips Finance* v. *Piddington* (1994) 70 P. & C.R. 592; *Penn* v. *Bristol and West Building Society* [1995] 2 F.L.R. 938; *United Carolina Bank* v. *Beesley*, 663 A. 2d 574 (Me. 1995), noted [1996] Rest. L. Rev. § 319.
[3] *Title Guarantee & Trust Co.* v. *Haven*, 196 N.Y. 487; 89 N.E. 1082 (1909).
[4] *Butler* v. *Rice* [1910] 2 Ch. 277; *United Carolina Bank* v. *Beesley*, 663 A. 2d 574 (Me. 1995), noted [1996] Rest. L. Rev. § 319.
[5] 27 N.H. 300 (1853).

second mortgage, which he believed to have been discharged, there was no reason why he should not have been allowed to set it up against the assignee of the second mortgage.[6]

6.2 Payment induced by Mistake

The cases of mistake induced by fraud are, of course, a subset of the set of cases of payment induced by a mistake. However, there is a vast number of cases where a payer or lender advances funds in reliance on a mistaken belief that he will receive valid and effective security for repayment. When this does not turn out to be the case, he has repeatedly been held to have been subrogated to the rights of a creditor who was paid off using the funds advanced. Similarly, where a purchaser of an incumbered estate assumes the payment of a prior mortgage, and pays it off, ignorant of subsequent liens on the property, he will be held to have been subrogated to the benefit of the mortgage.[7] While some cases may involve "unjust factors" other than mistake,[8] there are others where the payer or lender has little object for complaint other than his own ineptitude or impercipience,[9] and yet he is held entitled to relief. This body of cases seems more amenable to rationalisation in terms of unjust enrichment than some others. Mistake is a well known ground on which restitution can become available. However, many of these cases can be justified on the ground that the intention of payer and debtor was that the payer was to have a security

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[6] See the next section. *Cf. Ward-Harrison Co.* v. *Kone*, 1 S.W. 2d 857 (Tex. Civ. App. 1928), affirming *Kone* v. *Harper*, 297 S.W. 294 (Tex. Civ. App. 1927), noted in Comment, "Subrogation - Mortgages - Mistake in Discharge of Encumbrance on Real Property," (1928) 28 Col. L. Rev. 826. In that case, money was lent in order to discharge liens on land. A mortgage was granted to the lender. The original holder of the second lien on the property executed a deed which purported to subordinate his lien to the lender's mortgage. In fact, that holder had already transferred the lien to another party. The lender was unaware of this transfer because it had been improperly indexed in the public records. The borrower used the funds lent to discharge the first incumbrance on the property. It was held that the assignees of the lender were entitled to be subrogated to this first incumbrance, as against assignees of the second lien with notice of the lender's mistake. The result seems to be even more emphatically just than that in *Wilson* v. *Kimble*.

[7] See *Clute* v. *Emmerich*, 99 N.Y. 342, 352-3; 2 N.E. 6, 21 (1885). Successive purchasers who had assumed the payment of a first mortgage, and other mortgages which were substituted for it (the mortgagees being successively subrogated to the former rights of the first mortgagee) were held to have been subrogated to the rights of those mortgagees as against a subsequent judgment creditor, of whose lien they had not had notice. Finch J., on behalf of the court, said:

> "in no just sense can it be said, as against one claiming under the judgment, that the owners of the fee were bound to pay off the [mortgage]. While they had agreed to do so as to other parties, and as to them were primarily liable, they stood in no such relation to the [judgment creditor], and owed her no such duty."

See also *Stone* v. *Davenport Brothers*, 200 Ala. 396; 76 So. 312 (1917); *In re Hubbard* 89 B.R. 920 (Bkrtcy. N.D. Ala. 1988).

[8] Such as, perhaps, lack of capacity to contract on the part of the debtor or borrower: *Thurstan* v. *Nottingham Permanent Building Society* [1903] A.C. 6, affirming [1902] 1 Ch. 1, overruling [1901] 1 Ch. 88; *Snelling* v. *McIntyre*, 6 Abbott N. Cas. 469 (N.Y. 1879), cited in Sheldon, *op. cit.*, § 8, text at note 3.

[9] *E.g.*, *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737. Also, cases such as *Brown* v. *Maclean* (1889) 18 O.R. 533.

with priority. If this does not occur, then equity may hold the payer to have been subrogated as the closest way of placing the parties in the position which they had intended to occupy.

In England,[10] Canada[11] and Australia,[12] the fact that a payment was made under a mistake of law rather than of fact is no longer a bar to relief. In Ireland, there is a recent *dictum* by Keane J., with whom the other members of the Supreme Court agreed, to the effect that payments made under mistake of law were recoverable in the same circumstances as payments made under mistake of fact.[13] Previous cases had decided that a payment made under a mistake of law would be recoverable if the parties had not been on equal terms, or if the mistake had been the fault of the defendant.[14]

It is a defence to an action by a mistaken payer against the recipient of the payment that the defendant gave consideration for the payment, as through the discharge of a claim,[15] or that he has changed his position as a result of the payment.[16] If the payment was effective to discharge a pre-existing debt owed by a debtor to the recipient, it seems that the recipient will be able to claim both that it gave a good consideration for the payment, and that it has changed its position as a result of the payment (through the discharge of the debt).[17] This is shown by *Aiken* v. *Short*,[18] in which the plaintiff had purchased a supposed inheritance, which never in fact came into existence. The plaintiff paid a debt owed by the supposed heir to the defendant, which was secured by a charge on the inheritance. It was held that the plaintiff could not recover the payment from the defendant. The defendant had handed the bond and

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[10] *Kleinwort Benson Ltd.* v. *Lincoln City Council* [1998] 3 W.L.R. 1095; *Nurdin & Peacock p.l.c.* v. *D. B. Ramsden & Co. Ltd.* [1999] 1 All E.R. 941. In the last case, the payer paid in the mistaken belief that if it paid knowing that it might not be liable to make the payment, it could recover the payment if it later transpired that it had not been liable to pay it. It was held that the payment had been made under a mistake of law, namely that the sum was recoverable, and that therefore, the sum was recoverable. In other words, there had been no mistake at all. "[A]s the rhetoricians would put it - the bridge became passable at last by reason of its very impassability" (Robert Graves, *Count Belisarius*, Penguin edition, 1954, 375). The decision was no doubt very welcome to the payer's solicitors. See also Virgo, "Recent Developments in Restitution of Mistaken Payments," (1999) 58 C.L.J. 478.

[11] *Air Canada* v. *British Columbia* [1989] 1 S.C.R. 1161; 59 D.L.R. (4th) 161.

[12] *David Securities Pty. Ltd.* v. *Commonwealth Bank of Australia* (1992) 175 C.L.R. 353.

[13] *Dublin Corporation* v. *Building and Allied Trades Union* [1996] 2 I.R. 468, 484. See E. O'Dell, "Restitution," in R. Byrne and W. Binchy, *Annual Review of Irish Law 1997* (1998), 607 at 617-9.

[14] *Rogers* v. *Louth County Council* [1981] I.R. 265, following *Rogers* v. *Ingham* (1876) 3 Ch. D. 357; *Kiriri Cotton Co. Ltd.* v. *Dewani* [1960] A.C. 192, 204; *Dolan* v. *Neligan* [1967] I.R. 247.

[15] *Aiken* v. *Short* (1856) 1 H. & N. 210; *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677; *National Shawmut Bank of Boston* v. *Fidelity Mutual Life Insurance Co.*, 318 Mass. 142; 61 N.E. 2d 18; 159 A.L.R. 478 (1945).

[16] *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677; *Lipkin Gorman (a firm)* v. *Karpnale Ltd.* [1991] 2 A.C. 548; *Rover International Ltd.* v. *Cannon Film Sales Ltd. (No. 3)* [1989] 3 All E.R. 423, 441-2 *per* Dillon L.J.; *Lloyds Bank p.l.c.* v. *Independent Insurance Co. Ltd.* [1999] 2 W.L.R. 986, noted by Lawson, (1998) 142 S.J. 1158.

[17] Robert Goff J.'s judgment received approval in *Lloyds Bank p.l.c.* v. *Independent Insurance Co. Ltd.* [1999] 2 W.L.R. 986.

[18] (1856) 1 H. & N. 210.

instrument of mortgage to the plaintiff, who was given a receipt. There could therefore have been little doubt but that the defendant had accepted payment as discharge.[19]

6.2.a The Effect of Negligence on the Payer or Lender's right to Subrogation

Where a plaintiff brings an action to recover a mistaken payment, the fact that he could have discovered his mistake had he taken proper care is no defence.[20] In one influential American decision, the court assimilated the mistaken payer's right to subrogation to his right to recover a mistaken payment:

> "The remedy of subrogation is governed by principles analogous to those that govern actions to recover money paid by mistake. Money paid on a negotiable instrument under a mistake of fact may be recovered back however negligent the party paying may have been in making the mistake unless the payment has caused such a change in the position of the other party that it would be unjust to require him to refund."[21]

There are American decisions to the effect that a failure by a purchaser to conduct a title search of incumbrances on the property which he purchases is not sufficient to deprive him of the benefit of subrogation to a prior incumbrance which he satisfies.[22] Constructive notice of intervening incumbrances does not debar him from claiming subrogation. He will only be held not to have been subrogated if his negligence can be described as culpable.[23] There are similar decisions in relation to lenders, such as the

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[19] At 214, Pollock C.B. said that the defendant had a perfect right to receive the money from the debtor, and the plaintiff had paid it for him. Similarly, Platt B. said (at 213) that the defendant had received money which was actually due to her. It is another question whether the plaintiff could have claimed to have been subrogated to the defendant's rights against the debtor. It is felt that he could have been: he was a purchaser who failed to acquire any interest, but who paid a charge on the estate *bona fide*. He should therefore have been entitled to subrogation to the rights of the holder of the charge. *Cf. In re Sargent's Trusts* (1879) 7 L.R. Ir. 66, and *post*.

[20] *Kelly* v. *Solari* (1841) 9 M. & W. 54, 59 *per* Parke B.; Birks, "Misdirected funds: restitution from the recipient," [1989] L.M.C.L.Q. 296, 320. Note also *Central Guaranty Trust Co.* v. *Dixdale Mortgage Investment Corp.* (1994) 121 D.L.R. (4th) 53, where a first mortgagee had discharged its mortgage of record, in the mistaken belief that its mortgage had been paid. On learning of the error, it was permitted to recover the amount of the debt and interest from the proceeds of sale of the mortgaged property. In effect, the priority of the mortgage (which itself had never ceased to exist) was reinstated.

[21] *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 144-5; 115 N.E. 465, 467 (1917). It should be noted that, as the case was one of misappropriation by the defendant rather than payment by the plaintiff, if one is to isolate an "unjust factor," it would have to be ignorance rather than mistake. See *post*.

[22] *In re Hubbard*, 89 B.R. 920 (Bkrtcy. N.D. Ala. 1988).

[23] *In re Hubbard*, 89 B.R. 920, 923 (Bkrtcy. N.D. Ala. 1988), referring to *Restatement of the Law, 2d, Restitution* (tentative draft #2), April 6, 1984, section 31f, at 36:

> "The case may be one in which property burdened with two liens is sold for new value, and the purchaser discharges the senior lien without knowledge of the junior one, and the latter is not divested by the sale... In either case, absent a remedy for the transferee, the junior lienholder would be unjustly enriched by the advancement of his lien.

Canadian case, *Brown* v. *Maclean*,[24] in which the lender advanced money to the owner of property in order to pay off what he believed to be the sole incumbrance on the property. The owner was to execute a new charge to the lender which the lender believed would be a prior charge on the land. However, there was in fact a judgment lien on the property, of which the lender was ignorant due to the failure of his solicitors to perform a search. The judge held that the lender should be subrogated to the first mortgage which had been paid off, on the ground of his mistake; he would not have discharged the first mortgage had he known of the judgment lien.[25]

In the recent decision of *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[26] members of the House of Lords indicated that subrogation or a restitutionary remedy could be available even where a lender advanced funds under a unilateral mistake which arose as a result of its own carelessness. Lord Hoffmann stated that so far as he knew, there was "no case in which it has been held that carelessness is a ground for holding that a consequent enrichment is not unjust."[27] In that case, the lender intended that other creditors of the borrower would subordinate their claims to its, rather than that it itself would receive security. Therefore, the factual situation called other matters into consideration. However, the attitude of the House of Lords leaves little doubt that if necessary, it would approve of the decisions in *Brown* v. *Maclean* and the other cases discussed above.

It may be argued that these decisions adopt a rather indulgent approach towards lenders who are at least in part responsible for their own misfortunes. This is particularly so where a lender takes a security without conducting a proper land registry or companies office search.[28] On the other hand, Mitchell[29] feels that if the payer's mistake was *bona fide*, allowing him to succeed to a prior charge is not unduly prejudicial to subsequent incumbrancers, whose position is no worse than if the payer had not intervened.[30] Finally, as will be seen later, there are a number of cases where a lender took security, which

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> "In these circumstances the transferee's lack of care to discover the existence of the junior lien, by consulting public records or otherwise, is not alone a reason to withhold subrogation."

See also Tancredi and Shach, "The Equitable Subrogee vs. The Bankruptcy Trustee - New Uses for an Old Doctrine," 1997 American Bankruptcy Institute Journal 125.

[24] (1889) 18 O.R. 533, discussed in Mitchell, *op. cit.*, 117-8.

[25] See also *Whitson* v. *Metropolitan Life Insurance Co.*, 225 Ala. 262, 142 So. 564 (1932); *Federal Land Bank* v. *Henderson, Black and Merrill Co.*, 253 Ala. 54, 42 So. 2d 829, 834 (1949).

[26] [1998] 1 All E.R. 737.

[27] [1998] 1 All E.R. 737, 748.

[28] *Cf.* Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 238, who suggests that constructive notice of an intervening incumbrance should defeat a claim to subrogation, in order to "maintain the integrity of the relevant registers [of security interests]."

[29] *Op. cit.*, 119.

[30] *Cf. Ward-Harrison Co.* v. *Kone*, 1 S.W. 2d 857 (Tex. Civ. App. 1928), affirming *Kone* v. *Harper*, 297 S.W. 294 (Tex. Civ. App. 1927), noted in Comment, "Subrogation - Mortgages - Mistake in Discharge of Encumbrance on Real Property," (1928) 28 Col. L. Rev. 826. The author of the comment cites *Home Savings Bank of Chicago* v. *Bierstadt*, 168 Ill. 618; 48 N.E. 161; 61 Am. St. Rep. 146 (1897), to the effect that constructive notice of the intervening incumbrance will not bar the lender's right to subrogation (*cf.*

became unenforceable owing to the failure of the lender and borrower to perfect it. In some of these cases, the lender is held not to be entitled to subrogation. This has, however, sometimes been expressed to be on the ground that while the lender had initially been subrogated by virtue of his advance and its application to a secured claim, the claim to which the lender was subrogated had merged in the defective security which he took.[31]

6.2.b Payment of an Incumbrance in the mistaken belief that one has an interest in property subject to it

In the American case *Homestead Co.* v. *Valley Railroad*,[32] it was held that a party which believed itself to be entitled to certain land, under a mistaken construction of an act of congress, and had paid taxes on the land for many years, was not entitled to a lien on the land for those taxes, the payments having to be regarded as voluntary. However, Irish and English cases seem to be more understanding. It has thus been held that a purchaser of a policy at a void execution sale was entitled to a lien thereon in respect of premiums which he had paid.[33] Again, Birks' proprietary base theory does not account for this result.[34]

6.2.c Where the Payer or Lender receives a Security from the Debtor, but is unaware of an existing security on the property

In *Stothers* v. *Borrowman*,[35] the mortgagor requested a third party to "lift" the mortgage on certain lands. The third party paid a sum in respect of arrears and interest, and later paid off the entire principal and took an assignment of the mortgage. Though the third party was unaware of it at the time when he took the assignment, a second mortgage existed on the property. It was held that the third party occupied the position of first mortgagee both as respects the principal and the amount of his first payment of the arrears.[36] In *Gordon* v. *Snelgrove*,[37] a mortgagor applied to the plaintiff to pay off a first mortgage

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Brown v. *Maclean*). On the other hand, subrogation was denied in *Fort Dodge Building & Loan Association* v. *Scott*, 86 Iowa 431 (1892), where the lender had negligently relied on "an old abstract" of title.

[31] See *post*.

[32] 17 Wall. (84 U.S.) 153, 167; 21 L. Ed. 622, 623 (1872).

[33] *In re Sargent's Trusts* (1879) 7 L.R. Ir. 66. Also, *West* v. *Reid* (1843) 2 Hare 249 (supposed assignee under ineffective assignment had lien for premiums paid by him), *Ahmed* v. *Kendrick* [1988] 2 F.L.R. 22, 33, and see further, *post*.

[34] *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677, 689 *per* Robert Goff J.: "the kind of mistake that will ground recovery is ... far wider than the kind of mistake which will vitiate an intention to transfer property"; *Chambers* v. *Miller* (1862) 13 C.B. (n.s.) 125; Mitchell, *op. cit.*, 110; S. Worthington, *Proprietary Interests in Commercial Transactions* (1996), 124-5.

[35] (1913) 33 D.L.R. 179.

[36] *Cf. McMillan* v. *McMillan* (1894) 21 O.A.R. 343. The court applied *Chetwynd* v. *Allen* [1899] 1 Ch. 353. See also *Walcott* v. *Condon* (1853) 3 Ir. Ch. R. 1, discussed in section 4.1, *ante*.

[37] [1932] 2 D.L.R. 300.

on property, agreeing to grant him a fresh mortgage in return. This arrangement was carried out. Unbeknownst to the plaintiff, the defendant held an intervening second mortgage on the property. Sedgewick J. held that the plaintiff had been subrogated to the position of the first mortgagee, whom he had paid. He also held that the entry of the discharge of the first mortgage in the Land Registry had the effect of vesting it in the person who had the best right to call for the legal estate, *i.e.* the plaintiff. He also added that he felt that the plaintiff was entitled to succeed on the ground that he had made his payment under a mistake as to his private rights.[38]

The result in *Wilson* v. *Kimble*,[39] discussed in section 6.1, may also be justified on the ground of the purchaser's mistaken belief, induced by the fraud of the vendor and the second mortgagee, that the second mortgage had been discharged. The case is comparable to *Earl of Buckinghamshire* v. *Hobart*,[40] where a tenant in tail paid off a mortgage, believing himself to be the tenant in fee simple. It was held that even though the tenant had meant to extinguish the mortgage at the time of paying, it should be regarded as subsisting for his benefit, in view of his mistake at the time of paying.

Mitchell[41] raises the possibility that in such cases, where the payer makes his payment in the mistaken belief that there are no other incumbrances on the property, his mistake may not have been sufficiently fundamental to justify the granting of "proprietary restitutionary" relief, *i.e.* in this case, subrogation to a mortgage. This was because the payer was not mistaken as to the *existence* of the vendor's property, but as to its quality, which he imagined to be more valuable than it actually was. Mitchell feels that if one excluded mistake as a ground for proprietary relief on this ground, one would be driven to rely on the fact that the payer had a proprietary interest in the property before he made his payment.[42] The possibility has already been raised that such cases can be justified on the ground that equity assists in procuring the result which is closest to that which was intended by the payer: namely that he would obtain a first charge on the property.[43] Even if, on Mitchell's view, it was necessary to establish a mistake as to the existence of a *res* in order to allow the payer to obtain a proprietary right, the payer was certainly mistaken as to the existence of the intermediate incumbrancer's proprietary rights.

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[38] See also *Ferguson* v. *Zinn* [1933] 1 D.L.R. 300, a very similar case where the plaintiff drew a cheque in favour of the mortgagor, and took a mortgage to secure the same amount. The mortgagor either obtained payment of the cheque or endorsed it over to the first mortgagee. Thus, the case was one of a loan to the mortgagor, rather than of a direct payment to the creditor. Kingstone J. nonetheless followed *Gordon* v. *Snelgrove* in holding that the plaintiff had been subrogated to the position of the first mortgagee.

[39] 27 N.H. 300 (1853).

[40] (1818) 3 Swanst. 186.

[41] *Op. cit.*, 113 and note 27.

[42] Cases of payers who have an interest in the property prior to their payment of an incumbrance are considered *post*.

[43] Section 2.2 and 3.10, *ante*.

6.2.d Where a Lender mistakenly believes that other Creditors have subordinated their claims against the Borrower to that of the Lender

Banque Financière de la Cité v. *Parc (Battersea) Ltd.*[44] has already been considered in a number of contexts.[45] The singular circumstances of the case were that the plaintiff had advanced funds to one Herzig, the general manager of the holding company of a group of companies which included the defendant. The funds were advanced to Herzig with the intention that he would apply them to the use of the defendant, in discharging a debt owed by the defendant to the first secured creditor, R.T.B. This was done. Under the agreement for the loan, the plaintiff was to have priority over other creditors of the defendant which were members of the same group. Herzig gave the plaintiff a letter on the note-paper of the defendant, purporting to confirm that the companies in the group would not demand repayment of their loans to the defendant until the plaintiff had been repaid in full. The defendant issued a promissory note to Herzig, who assigned it to the plaintiff. In fact, the defendant and O.O.L., a sister company of the defendant which held a second charge over the defendant's property, were not aware of the letter and were held not to have been bound by it.[46]

The plaintiff claimed at first instance and in the Court of Appeal that it had been subrogated to the position of R.T.B. by virtue of its loan and the application of the funds lent to the payment of R.T.B. At first instance, Robert Walker J. held that the plaintiff had been so subrogated. The Court of Appeal reversed Robert Walker J.'s decision. It appears that each court considered subrogation in the context of the question whether or not O.O.L. had been unjustly enriched as a result of the loan by the plaintiff and its application by the defendant. The Court of Appeal held that although O.O.L. had been enriched at the expense of the plaintiff, this enrichment was not unjust as the plaintiff had failed to take elementary precautions to safeguard its interests, and neither the defendant not O.O.L. had been guilty of any misrepresentation. Furthermore, and crucially, if the plaintiff were held to have been subrogated, it would place the plaintiff in a better position than if the defendant and O.O.L. had in fact complied with the terms of the subordination letter.

On the further appeal to the House of Lords, counsel for the plaintiff placed his case on an additional footing. Rather than relying solely on a claim of subrogation to the position of R.T.B., he argued also that the plaintiff was entitled to a personal restitutionary remedy against O.O.L., on the ground that O.O.L. had been unjustly enriched at the plaintiff's expense. Lord Steyn considered the case

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[44] [1998] 1 All E.R. 737.
[45] Sections 3.10 and 6.2.a, *ante*.
[46] At [1998] 1 All E.R. 737, 739, Lord Steyn referred to the conclusion of Robert Walker J. that the letter was not binding on the defendant or O.O.L. either by means of agency or estoppel.

on this basis, though he stated that similar considerations pointed to the application of subrogation. However, the contours of the form of subrogation he envisaged are unclear. He stated that

> "It would admittedly not be the usual case of subrogation to security rights in rem and in personam. The purpose of the relief would be dictated by the particular form of security, involving rights in personam against companies in the group, which [the plaintiff] mistakenly thought it was obtaining."[47]

This appears to suggest that the plaintiff might have been subrogated to the rights of R.T.B. in so far as R.T.B. could exercise those rights against the defendant, O.O.L., and the other companies in the group. Thus, the plaintiff would not obtain proprietary rights, and would have no rights as against the rest of the world. Lord Clyde also held, in a brief judgment, that the plaintiff was entitled to succeed by means of a personal right to have priority over O.O.L. He stated that he would have had difficulty in accepting that the plaintiff could have been entitled to even a *pro tanto* right in the security of R.T.B., as the plaintiff had decided not to take a security. However, he also agreed with the reasons given by Lord Hoffmann, who decided the case on the basis that the plaintiff was entitled to a "limited" form of subrogation to the rights of R.T.B.

Lord Hoffmann, with whom Lords Griffith and Clyde agreed, held that the plaintiff was entitled to be subrogated to the position of R.T.B., but only as against O.O.L. Thus, he granted subrogation as a remedy, but relative only to O.O.L., and not as against the world at large. As has been noted in section 2.8, this was a highly innovative method. As has been seen, Lord Hoffmann distinguished between contractual subrogation and subrogation as a restitutionary remedy.[48] In the latter case, however, intention might still be relevant in order to show that the lender had not intended to take security, and that he should not therefore be subrogated to the rights of a secured creditor.[49] This issue therefore seems to have arisen at the level of considering whether a party was entitled to a restitutionary *proprietary* remedy.

In the case before him, Lord Hoffmann felt that, in the absence of subrogation, O.O.L. would be enriched at the plaintiff's expense, as O.O.L.'s claim would have been advanced in priority by the discharge of part of R.T.B.'s charge. The enrichment was *prima facie* an unjust one, as the plaintiff had advanced the money on the mistaken belief that it was getting a subordination letter in return which would give it priority over the claims of O.O.L., among others. The mistake was one as to either the authority of the holding company to contract on behalf of the other companies in the group or as to the power of the holding company to "ensure that the other group companies would postpone their claims."[50] The fact that

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[47] [1998] 1 All E.R. 737, 741.
[48] See section 1.3, *ante*.
[49] *Cf. Paul* v. *Speirway Ltd. (in liq.)* [1976] Ch. 220.
[50] [1998] 1 All E.R. 737, 747.

neither O.O.L. nor the defendant was a party to the mistake was immaterial. The carelessness of the plaintiff in failing to ensure that Herzig had authority to bind the companies in the group was not a factor which prevented the enrichment from being unjust.[51] Furthermore, it was not a precondition of a finding of an unjust enrichment that there should have been a misrepresentation or sharp practice on the part of the person who received the enrichment.

Lord Hutton similarly accepted that O.O.L. had in substance been enriched at the plaintiff's expense. He accepted that the plaintiff had lent the money in the expectation, raised by the "postponement letter," that all the members of the group of companies would postpone their claims against the defendant company until the plaintiff had been paid. Lord Hutton considered the matter in a more conventional manner than his colleagues. He held that the plaintiff was entitled to be subrogated to the position of R.T.B., although he agreed with the view of Lord Hoffmann that the order should state that the plaintiff was subrogated to the position of R.T.B. only as against O.O.L. and the other companies in the group.[52] He felt that the plaintiff would be entitled to subrogation if it could show that it had contracted for a "security," which had failed, with the result that another party would be unjustly enriched if subrogation were not allowed. He accepted that the postponement letter was a form of security, as, if effective, it would have given a priority to the plaintiff. In cases where subrogation took place where the lender had taken a defective security, an actual or presumed "mutual" intention was not a prerequisite.[53] Lord Hutton stated that in his view, subrogation took place unless its application would produce an unjust result. He rejected the arguments which were advanced by O.O.L. that the enrichment was not unjust. He did not accept that subrogation to the position of R.T.B. (albeit subject to the rights of R.T.B. in respect of the balance still due to it) would give the plaintiff more than it had bargained for: the result would be "not dissimilar" to that for which it had contracted. It was not necessary for the plaintiff to show that O.O.L. had been guilty of misconduct.[54] He therefore agreed that there should be a declaration that, as against O.O.L. and other members of the group of companies, the plaintiff was entitled to be subrogated to the charge of R.T.B.[55]

6.3 Where Payer or Lender receives a Security which is void or unenforceable

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[51] See section 6.2.a, *ante*.
[52] [1998] 1 All E.R. 737, 757.
[53] He quoted from the judgment of Nicholls J. in *Boodle Hatfield & Co.* v. *British Films Ltd.* [1986] P.C.C. 176, 182-4, to the effect that a lender who advanced money on a stipulation for security was unlikely to give consideration to the consequences if the security proved ineffective.
[54] He quoted from the judgment of Lord Goff in *Lipkin Gorman (a firm)* v. *Karpnale Ltd.* [1991] 2 A.C. 548, 572, to the effect that a wrong by a defendant is not a prerequisite to a claim for money had and received; the action was founded on the fact that the defendant could not in conscience keep the money.
[55] See also Mitchell, "Subrogation, Unjust Enrichment and Remedial Flexibility," [1998] Rest. L. Rev. 144.

In certain cases, a payer has paid off the debt of another at his request, receiving a security for the advance, which turns out to be void owing to the debtor's lack of capacity to grant it. On a restitutionary theory, subrogation has been justified in such cases either on the ground of the payer's mistake as to the validity or enforceability of his security, or on the ground of the failure of the consideration for which the payer or lender had bargained.[56] On an intention-based theory, the result has been justified on the presumed or actual intent of the payer in his dealings with the creditor.[57]

In *Ghana Commercial Bank* v. *Chandiram*,[58] the debtor had granted an equitable mortgage by deposit of title deeds. He instructed the equitable mortgagee to give the deeds to the appellant, on the appellant's undertaking to hold them for the benefit of the equitable mortgagee. A judgment creditor then issued execution in such a manner that any subsequent transfer or alienation of the debtor's property without the leave of the court was null and void. A few days afterwards, the debtor purported to grant a legal mortgage to the appellant, who paid the equitable mortgagee the amount due to him. It was held that the legal mortgage was null and void. However, the taking of a void legal security did not prevent the appellant from becoming entitled to the equitable mortgage upon payment. The Privy Council held that the appellant's intention had been that in the event that the legal mortgage proved invalid or ineffective, the equitable mortgage should be kept alive for its benefit. However, the appellant was not entitled to improve its lot beyond that for which he had initially bargained. Thus, the equitable mortgage only stood in his favour for the amount due to the bank at the time of execution by the judgment creditor, or at the time of payment by the appellant, whichever was less. Mitchell explains the decision on the ground of mistake, the appellant not being aware at the time of its advance of the judgment creditor's claim.[59] This seems wrong: the Council's advice expressly refers to the appellant's *intent*.[60]

There is a large number of similar cases where the payer paid the debtor, who then paid the creditor. Similar considerations apply. Some of these cases seem to have been decided on the basis of intention. Others may perhaps best be explained as equity attempting to secure to the payer the closest possible approximation to the position for which he had bargained. In *Chetwynd* v. *Allen*,[61] a borrower granted a legal mortgage of Blackacre, of which he was a trustee for his wife, and Whiteacre, which he owned beneficially, to a mortgagee, to secure £2000. The borrower later requested the lender to advance to him £1200, to pay off an existing mortgage on Blackacre, promising to transfer the mortgage to him, but without revealing that Blackacre belonged to his wife, or that Whiteacre was comprised in the first mortgage. The lender advanced the £1200, and the borrower applied £1000 of it to pay off part of the mortgage. The borrower then granted the lender an equitable mortgage of Blackacre to secure the £1200.

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[56] Mitchell, *The Law of Subrogation* (1994), 158-161.
[57] Birks, *op. cit.*, 391.
[58] [1960] A.C. 732.
[59] *Op. cit.*, 121.
[60] See also Birks, *op. cit.*, 390.

Without using the language of subrogation, Romer J. nonetheless held that the legal mortgage had been kept alive to the extent of £1000 as against Blackacre and Whiteacre. This did not prejudice the legal mortgagee, as the balance of his mortgage debt retained priority over the lender's entitlement to the mortgage. Furthermore, Whiteacre was to remain primarily liable for the payment of the £2000, both as regarded the legal mortgagee and the lender. In this regard, he noted that "by subsequent events, [Whiteacre] might have been so dealt with to the prejudice of [the wife] as to prevent [the lender] from asserting his equitable right to the benefit of the £1000 debt and securities for the same."[62] This appears to be an acknowledgement of the rule that the discharge of an estate which is primarily liable to pay a debt has the effect of releasing from liability an estate which is only secondarily liable. Romer J. also held that the granting of the equitable mortgage for £1200 was not inconsistent with the co-existence of the prior mortgage for £1000 in favour of the lender. The lender could not be held to have lost the benefit of his prior charge because, through the borrower's fraud, he was unaware of his exact rights. Furthermore, a valid prior security would not be held to have merged in an invalid later security.[63]

In *Thurstan* v. *Nottingham Permanent Building Society*,[64] an infant became a member of a building society. She purchased land, partly using money borrowed from the building society. In return for this and future advances, she executed a legal mortgage in favour of the society. Under section 1 of the Infants Relief Act 1874, all contracts entered into by infants for the repayment of money lent or to be lent were absolutely void. The building society made further advances which the borrower used to erect buildings on the land. When the building society discovered that the borrower was an infant, they ceased to make advances. They then took possession of the property and spent money in completing the houses. On attaining twenty-one, the borrower brought an action against the society to have the mortgage set aside, and claiming possession of the land.

Before the Court of Appeal, counsel for the borrower stated that she would not object to repaying the money lent to purchase the land.[65] The Court of Appeal held that the legal mortgage had been void under the Act. The advances made for the purpose of building were merely money lent, and the building society could claim no lien in respect of them. As regarded the money advanced to finance the purchase of

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[61] [1899] 1 Ch. 353.
[62] [1899] 1 Ch. 353, 357.
[63] [1899] 1 Ch. 353, 358.
[64] [1903] A.C. 6, affirming [1902] 1 Ch. 1, overruling [1901] 1 Ch. 88.
[65] [1902] 1 Ch. 1, 5. In *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, Lord Diplock regarded this concession as having explained in part the willingness of the Court of Appeal and House of Lords to allow subrogation in *Thurstan*'s case. At first instance, Joyce J. had held that the case should be decided "on the short and simple ground" that the advance of the money and the purchase of the land were all part of the same transaction, and that the borrower could not adopt one part of the transaction and repudiate another. She was not entitled to claim the property free of any claim or lien on behalf of the society. The

land, Vaughan Williams L.J. held that the society had in effect acted as the agent of the borrower, who could not adopt their act, by claiming the property, without indemnifying them by paying the purchase money. Without any contract to that effect, the society had a lien or charge for the repayment of that money. He stated that the society's right extended beyond a mere lien on the deeds:

> "The society, having paid off the vendor, have a right to the remedies of the vendor - have a right, that is, to enforce the vendor's lien."[66]

He also stated that so far as was necessary, the borrower was a trustee for the society of the land conveyed to her.

Romer L.J. agreed that the borrower could not "affirm the purchase and repudiate the advance." Therefore, the society could "stand in the shoes" of the vendor. The society had no lien in respect of their later advances. They might have been entitled to such a lien if the infant had acted fraudulently. He was willing to accept that as the society's money had been used to pay builders, the society might be entitled to stand in their shoes. However, since the builders did not have any lien, this could not assist the society.[67]

6.3.a Where security granted is unenforceable

In *Congresbury Motors Ltd.* v. *Anglo-Belge Finance Co. Ltd.*,[68] the Court of Appeal extended the ruling in *Thurstan* to the situation of a moneylender whose security failed because all the terms of the contract of loan were not comprised in a written memorandum of the contract. It was held that the

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"lien or charge" which the society was said to have seems to have extended to all the advances made by the society.

[66] [1902] 1 Ch. 1, 9-10.

[67] Cozens-Hardy L.J. agreed. He stated that the society should not have been in a worse position than if the borrower had been adult, but the mortgage had been forged. As, he held, subrogation had been allowed in such a case (*Brocklesby* v. *Temperance Building Society* [1895] A.C. 173), so it should be in this. The decision was followed in *Commonwealth Bank of Australia* v. *Horvath* (1996) A.N.Z. Conveyancing Reports 501; 1996 VIC LEXIS 1370; BC9601260, a case of a payment by the plaintiff to the vendor of the purchase price of property over which a mortgage was granted by the three purchasers, one of whom was a minor, the mortgage therefore being void. See Chong, "Resurrecting the Vendor's Lien: Commonwealth Bank of Australia v. Horvath," (1998) 6 Australian Property Law Journal LEXIS 2. A similar American case was *Snelling* v. *McIntyre*, 6 Abbott N. Cas. 469 (N.Y. 1879), cited in Sheldon, *op. cit.*, § 8, text at note 3. In that case, a husband and wife gave a mortgage for an advance made to them for the purpose of discharging a prior incumbrance. The wife turned out to have been an infant at the time of granting the mortgage; it was held that the lender had been subrogated to the position of the prior incumbrancer as against the wife. Birks, *op. cit.*, 390-3, states that *Thurstan* can only be understood as turning on the payer's intention. Mitchell, somewhat similarly, thinks that the decision is unjustifiable on a "proprietary base" theory, but can perhaps be justified on the ground that the parties' mutual intent would otherwise have been thwarted: *op. cit.*, 158.

[68] [1971] Ch. 81, affirming [1970] Ch. 294.

moneylender could stand in the place of the equitable chargees whose claims had been paid off using the funds it had advanced.

In the notorious case of *Orakpo* v. *Manson Investments Ltd.*,[69] the House of Lords overruled the *Congresbury Motors* decision. In *Orakpo*, a lender had advanced funds to a borrower under a number of contracts. The loans had been made to finance the purchase of property. In two cases, the money was to be applied to pay a vendor. In the other cases, it was to be used to pay off legal or equitable charges on the properties. The lender was to be given a first legal charge on each of the properties in return for the loan. The moneys were applied as intended, and the borrower duly granted the legal charges. However, the contracts of loan each omitted a material term, with the result that they became unenforceable under the Moneylenders Act 1927.[70] The contracts were not, however, void *ab initio*. The Act also imposed a limitation period for the enforcement of security:

> "No proceedings shall lie for the recovery by a moneylender of any money lent by him after the commencement of this Act or of any interest in respect thereof, or for the enforcement of any agreement made or security taken after the commencement of this Act in respect of any loan made by him, unless the proceedings are commenced before the expiration of twelve months from the date on which the cause of action accrued."[71]

The borrower now claimed that the legal charges were unenforceable, and sought to restrain the lender from taking any steps to dispose of the properties. In a counter-claim, the lender sought either the repayment of the loans or a declaration that it had been subrogated to the rights of the vendors or prior chargees who had been paid off using the funds advanced. At first instance, and on appeal, it was held, following *Congresbury*, that the lender had been subrogated. However, the Court of Appeal held that the counter-claim was time-barred.

On appeal, the House of Lords again held that the counter-claim was time-barred. The lender was deemed to have initiated proceedings for the recovery of a debt at the time when it delivered its counter-claim claiming to have been subrogated. The court considered that the lender's cause of action had accrued at the time when the borrower had applied the funds in paying the vendors and chargees. The lapse of time between these two dates exceeded the twelve month time period imposed by the statute. The House appears to have understood the counter-claim seeking a "declaration of subrogation" as a remedy to enforce the debt, and therefore equivalent to bringing proceedings for a sale of the property.

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[69] [1978] A.C. 95.
[70] Section 6 (1).
[71] Moneylenders Act 1927, section 13 (1).

It is felt that the nature of the relief sought by the lender was not in substance a claim to *enforce* a security. Granted that the lender sought a declaration that it was *entitled to* a security, it still seems mistaken to say that the lender was obliged to bring declaratory proceedings within twelve months of the application of the funds by the borrower. If the House had held that the lender had been subrogated, the lender would have had to be treated as if it had occupied the position of the vendors and chargees from the date on which they were paid by the borrower. As such, there is no reason why the lender should have been obliged to enforce the liens or charges within twelve months as long as the borrower was repaying the loan.

The twelve month period should, it is felt, only have been regarded as running from the time when the borrower stopped paying. Some members of the House regarded subrogation as an incident of the contract. This must have had the consequence that it had to be deemed to have occurred in the past, at the time of application of the funds by the borrower. Nonetheless, paradoxically, the House seemed to think that subrogation was a form of relief in the same way that an order for sale or the appointment of a receiver would be.

Beyond this point, the judgments given in the House differed. In an uninspiring judgment, Lord Salmon held that "[t]o apply the doctrine of subrogation in the present case would be absurd." This was because under the contract of loan, the moneys were only repayable after twelve months. However, if the lender were subrogated to the rights of the vendors and chargees, the debt would become immediately due. This is not necessarily so. Other cases have recognised that a creditor should not be allowed to improve his position by subrogation to the place of another creditor.[72] Thus, there is no reason why the court could not have held that the lender had been subrogated, but imposed a stay on his right to enforce the security pending the maturity of the debt under the original contract.

Lord Edmund Davies held that there could be no subrogation because the security taken by the lender here was valid, but unenforceable. In *Thurstan*'s case, the lender had obtained nothing in return for the advance. Here, the lender had obtained the security for which it had bargained. However, he could not enforce it owing to his own failure to comply with the statutory formalities. This displaced any entitlement to subrogation. He also felt that, if the lender had been subrogated to the vendors' liens or equitable charges, these would have merged in the legal securities taken.

Lord Keith of Kinkel was of the opinion that if subrogation took place in the present case, it would occur as a result of a contractual term, which, under section 6 of the Moneylenders Act 1927, should have been comprised in the written memorandum of the contract. Thus, any attempt by the lender to enforce the vendors' liens or equitable charges would be precluded by the section just as in the case of

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[72] See section 3.9, *ante*.

a legal security given to the lender. Lord Diplock also held that, if it had been intended that the moneys were to be used to pay vendors, or discharge incumbrances, then this should have been stated in the memoranda. If they were not intended so to be used, there could be no subrogation.[73]

It must be granted that there is authority that a chargee who fails to register his charge his charge under section 99 of the Companies Act 1963 cannot claim subrogation to liens or securities paid off with his advance.[74] Nonetheless, the decision has the odd result that a lender whose contract is void under statute is in a more favoured position than a lender whose contract is declared to be existing but unenforceable by statute.[75]

It is notable that all the members of the House seemed to treat a lender's right of subrogation as a result of an implied contractual term. While Lord Diplock stated that subrogation in some circumstances appeared to "defeat classification except as an empirical remedy to prevent a particular kind of unjust enrichment," he nonetheless claimed that a lender's right of subrogation to the position of a creditor who had been paid with the funds lent was based on the presumed mutual intention of the lender and borrower.[76] Although all the judges appear to have decided the case on the basis that subrogation was contractual, in *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[77] Lord Hoffmann explained the decision on the ground that restitution could not be allowed where it would be contrary to public policy or the terms of an Act.[78] Birks accepts that the case was decided on the ground of intention, and that the outcome was logical on that basis.[79] He does not think there could have been any restitutionary proprietary ground for relief, because the lender could not have retained any property in the money, which it had paid under a valid, but unenforceable, contract.[80]

6.3.b Where the Security granted is unenforceable owing to the Lender's failure to perfect it.

In a number of cases where a lender to a company received a charge over the company's assets as security for a loan, but failed to register it, he has been held not to have been subrogated to the rights of creditors who were paid off using the money which he advanced. In *Burston Finance Ltd.* v. *Speirway*

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[73] Viscount Dilhorne disagreed with this reasoning, stating that the memorandum did not have to state the legal effect or consequence of the contract made, merely the terms of the contract.
[74] *Capital Finance Co. Ltd.* v. *Stokes* [1969] 1 Ch. 261; *Burston Finance Ltd.* v. *Speirway Ltd. (in liq.)* [1974] 1 W.L.R. 1648. Compare, however, *In re White*, 183 B.R. 713 (Bkrtcy. M.D. N.C. 1995); noted [1996] Rest. L. Rev. § 321.
[75] See C. Mitchell, *The Law of Subrogation* (1994), 160-1.
[76] *Cf.* the discussion in section 1.3, *ante*.
[77] [1998] 1 All E.R. 737.
[78] [1998] 1 All E.R. 737, 747.
[79] *Op. cit.*, 392-3.
[80] *Ibid.*

Ltd. (in liq.),[81] Walton J. held that the lender in such a case was not entitled to the benefit of the unpaid vendor's equitable lien where the lender had stipulated for and obtained a legal charge on the properties bought by the company with the funds advanced. The judge seems to have accepted that the lender had *prima facie* been subrogated, but that the equitable lien had thereafter merged in the legal charge. As an additional ground for his decision, Walton J. stated that while the equitable lien could co-exist with a security which was void or completely unenforceable from its inception, it could not co-exist with a valid legal security. The legal charge created in that case extended to all of the property purchased, for the whole of the purchase price, and reserved a higher rate of interest than would be allowed on the vendor's lien. These factors refuted the suggestion that the lender had retained a lien.[82]

The fact that the legal charge obtained had later become unenforceable as against a liquidator and any other creditors did not alter the situation. He stated:

> "there is no doubt that the plaintiffs [lenders] got what they bargained for. They were merely lax in not taking steps to ensure that what they bargained for remained good against the world."[83]

That decision was followed by McWilliam J. in *In re South Coast Boatyard; Barbour* v. *Burke*.[84] In that case, the lenders had advanced funds to a company so that it could discharge debts due to a bank. In return, the lenders received a legal charge over a number of yachts. The lenders did not register the charge. McWilliam J. held that the lenders had not been obliged to do this under section 99 of the Companies Act 1963, and the Supreme Court affirmed this decision on appeal.[85] However, in case he was incorrect on this point, McWilliam J. considered whether or not the lenders could claim to have been subrogated to the bank's valid security on the yachts. He accepted that "until an agreement for security is implemented the right of subrogation would continue whether the agreement to create another security itself gave an equitable right [to the lenders] or not."[86]

It seemed, however, that in the present case, the legal charge had been created simultaneously with the loan. If that was so, then no right to subrogation arose at all, as the bargain was "perfectly clear" as to the security which the lender had sought and obtained. Alternatively, if the charge had not been contemporaneous with the loan, then the lenders had nonetheless lost any right to the bank's security when they obtained the security for which they had bargained. It is not clear whether or not the lenders filed a cross-appeal against this portion of McWilliam J.'s judgment, but the Supreme Court did not refer

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[81] [1974] 1 W.L.R. 1648.
[82] Walton J. thought that the difference between the respective rates was of particular significance. He felt that this was a reason why *Coptic Ltd.* v. *Bailey* [1972] Ch. 446 had been wrongly decided.
[83] [1974] 1 W.L.R. 1648, 1657.
[84] Unreported judgment of McWilliam J., High Court, 1979 No. 280 Sp., delivered 20th November, 1979.
[85] [1980] I.L.R.M. 186 (*sub nom. In re South Coast Boatyard Ltd. (in vol. liq.); Barber* v. *Burke*).
[86] At page 9 of the judgment.

to subrogation in their judgment. American law seems to be more indulgent to the lender. In *In re White*,[87] it was held that a lender which had failed to record its lien on a lorry had been subrogated to a prior lien on it which had been paid off using the funds advanced. Goff and Jones agree with the results of the Irish and English cases, on the ground that subrogation in such circumstances would have the effect of avoiding the statutory policy requiring publicity of corporate security in order to obtain priority on a winding-up.[88]

6.4 Where Payment is made by the Debtor or another party using misappropriated funds

In a situation where funds belonging to a party are misappropriated and applied, in whole, or in part in discharging debts, the party entitled to the fund may be held to have been subrogated to the position of the former creditor, whose claim was discharged by means of the funds.[89] In the type of case under discussion, clearly the party which misappropriated the funds or other property has been guilty of a wrong: breach of trust or fiduciary duty, fraud, conversion, detinue or trespass to chattels. This is reason to grant a remedy against him. However, many such cases involve persons in a fiduciary capacity, and it sometimes occurs that the moneys which he appropriates are applied in discharge of a debt due from some other innocent party, with respect to whom he also occupies a fiduciary position. It is generally held that the victim retains a property interest in the misappropriated property, and can trace his property into a substitute.[90] Whether the victim retains a legal or equitable interest may depend on whether or not the

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[87] 183 B.R. 713 (1995); [1996] Rest. L. Rev. § 321.

[88] *Op. cit.*, 165-6.

[89] *Newell* v. *Hadley*, 206 Mass. 335; 92 N.E. 507 (1910). In *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, 782-3, Millett L.J. stated that if a trust funds were applied to the payment of a debt, there was no legal impediment to holding that the beneficiary had been subrogated to the creditor's rights. *Contra*: *In re Diplock's Estate; Diplock* v. *Wintle* [1948] Ch. 465, 549-550. See also the authorities cited by Mitchell, *op. cit.*, 115, note 35; Oesterle, "Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in U.C.C. § 9-306," (1983) 68 Cornell L. Rev. 172, 185 note 27; *Restatement of Restitution* (1937), § 102 comment i. One may compare cases of marshalling: A. has a lien on Blackacre and Whiteacre, for the same debt, each belonging to the debtor. B. has a subsequent lien on Blackacre only. If A. exercises his lien on Blackacre, B. will recover nothing. So as to prevent A. from arbitrarily defeating B.'s security, if A. recovers from Blackacre, and is paid in full, B. will be held to have been subrogated to A.'s rights over Whiteacre. See *post*.

[90] Generalisations, are, however, dangerous in this area. S. Worthington, *Proprietary Interests in Commercial Transactions* (1996), 122-9, states that the original owner retains legal title in cases of contracts void *ab initio* for mistake and cases of theft. However, where a contract is void under statute, she states that property can pass to the initial recipient. At least since *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669, it seems that property can pass to the recipient under a void contract (see Lord Goff of Chieveley at 690). In *Lipkin Gorman (a firm)* v. *Karpnale Ltd.* [1991] 2 A.C. 548, a partner in a firm misappropriated money from the firm's bank account, and gambled and lost it at a casino. On the one hand, it was held that the partner obtained legal title to the money withdrawn (Lord Goff at 573). On the other hand, it was also held that the firm retained a common law right to the return of the money, because they were "owners" of the chose in action constituted by the indebtedness of the bank to them, and they could trace their property into its product (Lord Goff at 574). This was an apparently paradoxical result. See L.D. Smith, *The Law of Tracing* (1997), 332-3. In case of outright theft, property cannot pass to the thief. However, perversely, this may work against the interest of the original owner, as he cannot claim to have any equitable interest in the property in the hands of the thief, or in its traceable proceeds. He is restricted, it seems, to personal

contract was void *ab initio*.[91] This may, according to some views,[92] permit the victim to trace his property into the discharge of a debt, and thus be subrogated to the former rights of the creditor.[93] These cases are usually explicable on the basis that the claimant is asserting a right to his property, in a substitute form.[94] If the claimant retains or regains legal title, arguably, he cannot trace the property or its substitutes in equity into the hands of the wrongdoer or others, as the equitable interest has not been separated from the legal title.[95] In attempting to explain the cases in a restitutionary framework, it is necessary to identify a

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remedies. Certain jurisdictions hold that a thief holds stolen property on trust for the victim: see Worthington, *op. cit.*, 128, note 54, and Mitchell, *op. cit.*, 116, note 36 (observing that such decisions employ a "very strained use" of the term "fiduciary relationship"). Note also *Newton* v. *Porter*, 69 N.Y. 133, 140 (1877), where it was held that the victim was entitled to trace into substitutes for the stolen property, notwithstanding the absence of a fiduciary relationship. Similarly, a *dictum* in *Succession of Onorato*, 219 La. 1, 26; 51 So. 2d 804, 812; 24 A.L.R. 2d 656 (1951), applying the civil law of Louisiana. See Oesterle, *op. cit.*, at 178 note 13.

[91] Worthington, *op. cit.*, 124-9.

[92] Birks, *op. cit.*, 93-8; Smith, *op. cit.*, 152-4.

[93] *Sinclair* v. *Brougham* [1914] A.C. 398, 412 *per* Viscount Haldane L.C., with whom Lord Atkinson agreed; 440-1 *per* Lord Parker of Waddington; *Newell* v. *Hadley*, 206 Mass. 335, 342; 92 N.E. 507, 510 (1910); *Wilson* v. *Todd*, 217 Ind. 183; 26 N.E. 2d 1003; 129 A.L.R. 192 (1940).

[94] Smith, *op. cit.*, 153, points out that a claimant with a merely personal claim might still trace the money paid by him or taken from him into the discharge of a debt. This follows from Smith's distinction between *tracing*, which is merely a process of identifying the product of value, and *claiming*, which is the assertion of rights against the product so identified, whether personal or proprietary. Cases of tracing followed by a personal claim are rather rare, however. See also Birks, *op. cit.*, 85-7; "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 84; *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, 776 *per* Millett L.J.

[95] Worthington, *op. cit.*, 128. At note 53, the author observes that "whether in practice a court would be prepared to hold itself so constrained is another matter." The reservation expressed in this aside has proved to be justified. In *Trustee of the Property of F.C. Jones & Sons (a firm)* v. *Jones* [1996] 3 W.L.R. 703, the Court of Appeal of England and Wales held that the trustee in bankruptcy of the original owner of funds was entitled to claim against the recipient of the funds. The effect of the bankruptcy was that legal title, which had been in the recipient, was retrospectively revested in the trustee (*i.e.*, as if the recipient had never had title). It was held that the trustee was entitled to trace (in the sense of identifying) the property into its exchange product (a fund of increased size). However, he would only have had a personal claim or *remedy* against that fund. In other words, tracing was available (at common law), to identify the product of the property. However, only a personal remedy was available against the recipient of the fund. Whatever about the theory, the result seems to work in practice. Smith, *op. cit.*, 328-30, 332-9, concludes that the case is a recognition of a peculiar form of common law personal claim in support of a proprietary right, *i.e.*, a claim to the value of an asset or its product. As to the correctness of the tracing exercise carried out, see Davern, "Common Law Tracing, Profits and the Doctrine of Relation Back," [1997] Rest. L. Rev. 92, 95. On the common law tracing rules, see Smith, *op. cit.*, 162-174, 278 (arguing that there is only one set of tracing rules for identification purposes, at law or in equity). Worthington might argue that if a claimant is entitled to have specific property transferred to him, then he has an equitable proprietary interest, as equity will treat as done the obligation to transfer the property: *op. cit.*, 148, 193 and note 35. In this regard, she regards it as essential to the creation of this interest that the agreement be capable of specific performance: *op. cit.*, 148, note 13. See also Smith, *op. cit.*, 327. On the other hand, Birks, "Personal Restitution in Equity," [1988] L.M.C.L.Q. 128, 131, states that an obligation to transfer something does not automatically give rise to a proprietary interest in the person entitled to the transfer. This seems consistent with the view of the majority of the Supreme Court in *Tempany* v. *Hynes* [1976] I.R. 101.

In his *Introduction*, at 67, Birks describes the effect of the exercise of the "power" over the product of the traced value as restitution "on the metaphysical level." The effect is that property had never passed, and the enrichment was "passively anticipated." However, he states elsewhere that the anticipation of an enrichment is not restitution if at the moment of receipt by the defendant, the plaintiff

factor which renders the enrichment of another party to be unjust. The fact that a wrong was done to the claimant is not generally considered to be enough to entitle him to restitution from the ultimate recipient (though it may well entitle him to compensation from the wrongdoer). The unjust factor has been said to be the *ignorance* of the claimant that his property was being misappropriated.[96]

While it may be true in some cases to say of a person whose property was misappropriated by another that he was ignorant of the fact, this will not always be the case (other cases may be examples of impaired consent). There can be no doubt that, *ex hypothesi*, the claimant did not consent to parting with his property. However, it seems odd to say that his lack of consent is itself the cause of his entitlement to recover. His lack of consent may prevent property from passing,[97] or may render the immediate or ultimate recipient a resulting or constructive trustee of the property or its proceeds.[98] However, it is felt that it is his property right which entitles him to claim the product of his property, perhaps in the form of a fund of increased value. On the other hand, Birks has offered the view that, in any case where a tracing exercise is carried out, the claimant's rights to the product of the exercise are always restitutionary, even if the initial right was a proprietary one.[99] This derives from Birks' view that a claimant with a right to trace

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retains the property (*op. cit.*, 14, 70-1). It may be noted that there is case law in favour of the proposition that if one is entitled to payment out of a certain fund, then one is entitled to an injunction to restrain its disposal. This does not, however, necessarily mean that one has a proprietary interest in the fund: *Kearns* v. *Leaf* (1864) 1 H. & M. 681, 708 *per* Page-Wood V.-C. (a policy-holder was entitled to an injunction against the insurance company to restrain the company from transferring its assets without making proper provision for paying the plaintiff's policy); *Cummins* v. *Perkins* [1899] 1 Ch. 16, 18, 19-20 *per* Lindley M.R; *Sarge Pty. Ltd.* v. *Cazihaven Homes Pty. Ltd.* (1994) 34 N.S.W.L.R. 658. *Cf. Owen* v. *Homan* (1853) 4 H.L.C. 997, 1036 (the court refused an application by an unsecured creditor for the appointment of a receiver over the estate of a married woman).

[96] Birks, *op. cit.*, 140-2; Birks, "Misdirected funds: restitution from the recipient," [1989] L.M.C.L.Q. 296, 305-6; "Restitution," [1996] All E.R. Annual Review 366, 372 (offering this as an explanation for *Jones*); Mitchell, *op. cit.*, 114; O'Dell, "Restitution," in R. Byrne and W. Binchy, *Annual Review of Irish Law 1996* (1997), 502 at 519.

[97] *Cundy* v. *Lindsay* (1878) 3 App. Cas. 459.

[98] *Chase Manhattan Bank N.A.* v. *Israel-British Bank (London) Ltd.* [1981] Ch. 105; *In re Irish Shipping Ltd.* [1986] I.L.R.M. 518 (recipient of moneys paid under mistake a constructive trustee of the moneys); Smith, *op. cit.*, 296, and note 22. *Cf. In re P.M.P.A. Insurance Co. Ltd.*, unreported, Lynch J., 1983 No. 7208P, judgment delivered on the 24th October 1985.

[99] Birks, "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 91-2. In "Restitution," [1996] All E.R. Annual Review 366, 371, he writes:

> "The right in the money at the end of the tracing chain is not the same right as the trustee [claimant] held at the head of that chain. At the head of the chain he was entitled to a claim in personam against a bank. At the end of the chain he was the owner of money paid into court by another bank. That is not a survival of a pre-existing proprietary right... The *Jones* right is a new right, raised in the form of a power by operation of law and later crystallised by the act of the power-holder. The raising of the power effects restitution or, more accurately, enables the power-holder to effect restitution, thus reversing an unjust enrichment of the other at his expense. Restitutionary in effect, the right cannot be explained in terms of any originating event other than unjust enrichment."

has only a power to re-vest property in him. This power "is generated by the unjust enrichment of the alienee in order to effect restitution."[100] When value is traced into a new asset, a new right arises, to reverse the enrichment of the respondent.[101] As this right is created in order to effect the return of property to the claimant, Birks classifies it as restitutionary.[102]

Swadling has advanced another argument against the classification of this type of case as restitutionary, observing that, in cases where the claimant retains a legal or equitable interest, the wrongdoer has not obtained anything more than possession at the claimant's expense.[103] On the other hand, Grantham and Rickett argue that, even if title does not pass, a wrongdoer may nonetheless obtain other benefits at the claimant's expense.[104]

Grantham and Rickett do state, correctly in the present author's view, that the law accords precedence to claims to protect existing property rights. Where the claimant retains title, that provides a ground to claim the property and its substitutes, independently of the question of unjust enrichment.[105] So, it is possible that a restitutionary remedy may be awarded in order to vindicate a property right, quite aside from any question of unjust enrichment.[106] However, if a claimant's title comes to be destroyed, as, in certain circumstances, through an exception to the *nemo dat quod non habet* rule, then he may have a

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In "On taking seriously the difference between tracing and claiming," (1997) 11 T.L.I. 2, 10 note 45, the same author states that in some cases the law may vindicate a right of property born out of unjust enrichment, giving *Trustee of the Property of F.C. Jones & Sons (a firm)* v. *Jones* [1996] 3 W.L.R. 703 as an example.

[100] Birks, "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 92.

[101] *Ibid.*

[102] Birks, *Introduction to the Law of Restitution* (1985, rev. ed. 1989), 57-64. Also, Smith, *op. cit.*, 300.

[103] Swadling, "A Claim in Restitution?" [1996] L.M.C.L.Q. 63, 65. Birks, *Introduction to the Law of Restitution* (1985, rev. ed. 1989), 14, 70-1, observes that if the claimant retains his property rights, there is no issue of restitution - the retention of property anticipates the danger of unjust enrichment, and prevents it. At 14, he states: "The crucial moment to look at is the defendant's receipt of the existing benefit. If at that moment the law passively preserves existing rights, there is no restitution." Similarly, "Establishing a Proprietary Base," [1995] Rest. L. Rev. 83, 92. However, where legal title passed, but the plaintiff was held entitled to an equitable interest, this was a newly created interest, and therefore restitutionary. See also Smith, *op. cit.*, 300-1. Pearce and Stevens, *op. cit.*, 543, disagree with Birks' theory of a restitutionary "power" by which a claimant may vest property in himself, and favour the view that a claim consequent on tracing is one in respect of retained property, no question of restitution therefore arising.

[104] Grantham and Rickett, "Restitution, Property and Ignorance - A Reply to Mr. Swadling," [1996] L.M.C.L.Q. 463, 464-5. Birks, "Restitution," [1996] All E.R. Annual Review 366, 371, states that it is difficult to resist the inference that English law accepts that a recipient is enriched by the possession of property, even if he has acquired no title to it.

[105] *Op. cit.*, 465; Grantham and Rickett, "Restitution, Property and Mistaken Payments," [1997] Rest. L. Rev. 83, 84, 87. *Cf.* Smith, *op. cit.*, 293. Birks says that there is still an unjust enrichment in such a case: "Restitution," [1996] All E.R. Annual Review 366, 371.

[106] See Virgo, "Reconstructing the law of restitution," (1996) 10 T.L.I. 20, 22-4.

restitutionary (personal) claim against the wrongdoer, and (perhaps) an ultimate recipient of the value of the asset.[107]

There is a first instance English decision which denies an entitlement to subrogation in a case where misappropriated money was applied to the payment of a debt. In *Euroactividade A.G.* v. *Mason Investments Ltd.*,[108] a director of the plaintiff company had diverted funds to finance the purchase of a house by the defendant company for the benefit of his son. A bank, Schroders, employed by the defendant, had paid the deposit, and then received a larger sum from the director out of the plaintiff's funds. Schroders then paid the balance of the purchase price to the vendor, this sum greatly exceeding the credit balance standing to the credit of the director. The defendant company executed a mortgage for the amount of this advance to Schroders. The director later paid off the mortgage with the plaintiff's funds. It was held, first, that the plaintiff could not trace its funds into the property, as Schroders had paid for the property before the funds came into its hands.[109] Thus, no question of "backward tracing" was entertained.[110] Secondly, it was held that the plaintiff could not be subrogated to the rights of Schroders

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[107] Birks, as has been seen, would deny any property is retained where the original item is exchanged for something else. Rather, the claimant has a right to vest the traceable product of his original item in himself.

[108] Unreported, Queen's Bench Division, High Court of England and Wales, Judge Mildon Q.C., 18th April 1994.

[109] This is consistent with the view of Leggatt L.J. in *Bishopsgate Investment Management Ltd. (in liq.)* v. *Homan* [1995] Ch. 211, 221-2 (judgment in which was delivered three months after that in *Euroactividade*), that where an asset was acquired on credit, and then paid for with misappropriated money, the rightful owner of the money could not trace its value into the asset. In the same case, Dillon L.J. felt that it was arguable that this form of tracing could take place if "there was an inference that when the borrowing was incurred it was the intention that it should be repaid by misappropriations of [the claimant's] moneys" (at 216). Henry L.J. agreed with both judgments (at 222). Leggatt L.J. did (221-2) state that he saw force in the argument that if an asset already owned by a recipient were pledged as security for a debt, which was later repaid by means of the misappropriated money, then the party entitled to that money could be subrogated to the former rights of the secured creditor. In *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 414, Hobhouse L.J. referred to *Bishopsgate*, stating, *obiter*, that one could not trace value into an asset acquired before the value reached the recipient. Morritt L.J., who dissented in the result in *Foskett*, also approved of Leggatt L.J.'s comment: [1997] 3 All E.R. 392, 421.

[110] See Smith, *op. cit.*, 147-8; "Tracing into the Payment of a Debt," (1995) 54 C.L.J. 290, 292-5; *Agricultural Credit Corporation of Saskatchewan* v. *Pettyjohn* (1991) 79 D.L.R. (4th) 22; *Foskett* v. *McKeown* [1997] 3 All E.R. 392, 409 *per* Scott V.-C. (leaving the point open); Mitchell, "Tracing trust funds into insurance proceeds," [1997] L.M.C.L.Q. 465, 467-8; Mitchell, review of Smith, *op. cit.*, (1997) 11 T.L.I. 116, 117. Smith discusses the situation where a person purchases an object on credit, and then receives the funds which it is sought to trace, and uses them to pay the seller. In the present case, Schroders paid for the property, which was conveyed to the defendant. As security for this, Schroders was given a pledge over the malfeasant director's shares in the plaintiff. After the purchase of the property, the defendant granted a mortgage to Schroders, who discharged the shares. Schroders was later repaid with the plaintiff's money. It is felt that, notwithstanding the views of Leggatt L.J. in *Bishopsgate* and of Hobhouse and Morritt L.JJ. in *Foskett*, referred to in the last note, the fact that Schroders was paid after it had caused the defendant to acquire the property should not have been a reason to stop the tracing exercise. The value of the plaintiff's funds should have been traceable backwards through (d) the discharge by Schroders of the mortgage over the house; (c) the release of the pledged shares in return for the mortgage on the house; (b) the pledging of the shares in return for the payment to the vendor; (a) the

against the defendant. After saying that subrogation was impossible because Schroders' rights had been extinguished, Judge Mildon Q.C. then offered the view that if the plaintiff had itself paid Schroders, it *would* have been subrogated.[111] However, as it "was not a party to *its funds* being used to pay off the outstanding loan to Schroders," (emphasis added), it was not so entitled.[112] In other words, the victim of misappropriation or theft was in a worse position than a party which itself paid the money, though under a mistake or some other unjust factor. Despite these conclusions, the judge then decided to *impose* a charge on the property in favour of the plaintiff, on the basis that the defendant had received a benefit for no consideration, with imputed knowledge of the plaintiff's rights. Thus, the judge achieved by an arbitrary *ex post facto* method a result which could have been achieved, in conformity with principle, through subrogation. The reasoning is insupportable, though the outcome was a just one.[113]

The most recent English decision which is relevant to the current topic is *Foskett* v. *McKeown*.[114] The case does not, however, fit the precise pattern of the previous cases, and the relevance of subrogation seems to be almost accidental. The result reached by two of the three judges in the Court of Appeal rests in part, at least, on the ground that the claimant beneficiaries of one trust had been subrogated to the trustee's right of indemnity against the funds of another trust, of which he was also a trustee. The trustee misapplied the funds of the first trust to the payments of premiums on an insurance policy of which he was also a trustee, for different beneficiaries. In effect, he applied funds belonging to one trust to the use of another. In total, five premiums were paid on a policy on his life. He paid the first two using his own funds. He paid the last two using funds which belonged to the claimant beneficiaries. The provenance of the money used to pay the third premium was disputed, though Scott V.-C. at least was prepared to accept that it probably came from the claimants' money. At the time of the payment of the third premium, the policy was, arguably, beneficially vested in the trustee,[115] but thereafter, it became vested beneficially in the defendants, who were quite unaware of the trustee's misfeasance.[116] Under the terms of the policy, if premiums were not paid, the policy would be deemed to have been converted into a "paid up" policy,

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payment to the vendor in return for the conveyance of the house to the defendant. This process ultimately leads to the house, in the hands of the defendant.

[111] He did not attempt to reconcile these successive sentences.

[112] The judge seems to have contradicted himself by describing the funds as belonging to the plaintiff, as he had earlier held that the plaintiff could not trace "its money" into the payments to Schroders.

[113] *Cf.* Mitchell, *The Law of Subrogation* (1994), 116: subrogation should have been allowed, as the plaintiff's money had been misappropriated without its knowledge.

[114] [1997] 3 All E.R. 392.

[115] [1997] 3 All E.R. 392, 407 *per* Scott V.-C.

[116] Chambers, "Tracing, trusts and liens," (1997) 11 T.L.I. 86, 89, thinks that the timing of the vesting in the defendants may be significant: if the defendants had received property which had already been improved by application of some of the claimants' money, then either (a) that property could be regarded as having been acquired in part with the claimants' money, or (b) a constructive trust imposed on the property in the hands of the trustee would have continued to bind the policy when it vested in the defendants. It is felt that there is more force in argument (b) than in (a). Under argument (b), a constructive trust could only have arisen in the proportion that the claimants' contribution to the third premium represented to the whole of the first three premiums.

under which the amounts of future premiums would be deducted from accumulated "units" under the policy. It was only if the units were exhausted that the policy would lapse. In the events which transpired, the policy would not have lapsed even if no payments of premiums had been made at the times when the trust funds were so applied. By a majority, the Court of Appeal held that the claimant beneficiaries were entitled to an equitable lien on the proceeds of the policy to the amount of the premiums which had been paid out of their funds, with interest.

The first question was whether the claimant beneficiaries could trace their money into the proceeds of the policy. Scott V.-C. held that they could, giving the reason that they had been subrogated to the trustee's right of indemnification from the trust assets in respect of advances made by him for the use of the trust.[117] This seems to short-circuit the tracing process, however, as it takes it for granted that the premiums operated to purchase or improve the policy.[118] Thus, he does not seem to have fully considered the issue of tracing.[119]

Having decided for this reason that the premiums could be traced into the proceeds of the policy, the thornier problem of the extent of the beneficiaries' interest arose. Scott V.-C. held that the beneficiaries were entitled to a charge on the proceeds of the policy to reimburse them the amount of the trust funds which were misapplied to that purpose (together with interest). This was not, he felt, a case of the purchase of an asset by instalments. Rather, it was analogous to the use of trust funds to improve an existing asset. The policy was in effect the contractual right to the payment of a certain sum upon the occurrence of certain events. In Scott V.-C.'s view, the policy became vested in the trustee upon the payment of the first premium. He did not accept that the payment of later premiums could have the effect of divesting the trustee, or the defendant beneficiaries, of their vested interests.[120] He made this conclusion having specifically rejected the argument that the policy was solely the traceable product of the first premium paid.[121] He stated that the mere use of a claimant's property in part payment for an asset did not give the claimant a proprietary interest in the asset in the absence of an agreement to that effect, or a trust relationship.[122] This was aside from any question of subrogation. Even in the case of a purchase by

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[117] Following *In re Leslie; Leslie* v. *French* (1883) 23 Ch. D. 552, 560 *per* Fry J.

[118] There is an even greater problem. If the only ground on which the claimants were entitled to trace their money into the policy and its proceeds was through this subrogation, this would have predetermined the next question - of the extent of the interest thus acquired - as they could not have acquired by subrogation any greater interest than that to which the trustee might have been entitled, and his lien would have been limited to the amount necessary to ensure his indemnification. See Mitchell, "Tracing trust funds into insurance proceeds," [1997] L.M.C.L.Q. 465, 469-70, and, generally, *post.*

[119] *Cf.* Chambers, *op. cit.*, 86-7, who interprets the judgments of Scott V.-C. and Hobhouse L.J. as holding that the claimants could *not* trace their money into the policy and its proceeds.

[120] [1997] 3 All E.R. 392, 405, doubting the authority of *Gravesend Corporation* v. *Kent County Council* [1935] 1 K.B. 339.

[121] [1997] 3 All E.R. 392, 401-2. *Cf.* Chambers, *op. cit.*, 87.

[122] [1997] 3 All E.R. 392, 405. This is possibly a re-affirmation of the requirement of a fiduciary relationship before tracing is available in equity. On the other hand, Birks and Smith strongly argue that a

instalments, he said that if the first instalment was paid by the recipient of the money, the entire legal and beneficial interest in the purchased property would vest in him, and would not be divested by subsequent payments using the claimant's funds.[123] There was no basis on which to impose a constructive trust over the policy proceeds in favour of the claimant beneficiaries, as the trustee had not in any sense benefited from his breach of trust.[124]

Hobhouse L.J. came to the same conclusion. He seemed to think that the issue of tracing did not arise, because an asset was not acquired with the claimants' money. The fact that the claimants' money was applied to the premiums did not, in his view, raise any question of tracing their value into the proceeds of the policy. The mere improvement of property previously acquired could not permit a claimant to trace his value into the asset.[125] He had stated that the claimants had established "their right to trace their property into the payment of [the] premiums."[126] He also regarded the defendant beneficiaries as having in effect conceded that the claimants' money could be traced into the policy and its proceeds, and that the claimants should have a charge or lien to the amount of the premiums paid.[127] He therefore

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fiduciary relationship should only be relevant to the type of claim which can be made against an asset, not to the initial identification process of tracing: Birks, "On taking seriously the difference between tracing and claiming," (1997) 11 T.L.I. 2; Smith, *op. cit.*, 120-30.

[123] *Tempany* v. *Hynes* [1976] I.R. 101 (in which it was held that prior to the completion of a contract of sale, a purchaser of land only acquired a beneficial interest in the land proportionate to the amount of the purchase price which he had paid) might require a different result in Ireland. See A. Lyall, *Land Law in Ireland* (1994), Appendix A, and J. Farrell, *Irish Law of Specific Performance* (1994), paras. 11.01-11.13.

[124] He did say that if the policy had been beneficially vested in the trustee, the claimant beneficiaries would have been entitled to a *pro rata* interest in the proceeds on the basis of a constructive trust: see *ante*. However, even this was apparently subject to establishing that the use of the funds had *increased* the value of the policy: [1997] 3 All E.R. 392, 408. If this could not be established, the beneficiaries could only be entitled to a charge to reimburse themselves.

[125] [1997] 3 All E.R. 392, 415. However, on the same page, he states that "[t]he value of the property after the expenditure is relevant to the question whether tracing is still possible or realistic..." This seems to envisage tracing as taking place *after* (a) the application of the money has been established, and (b) the value of the asset to which the money was applied has been ascertained. It seems that Hobhouse L.J. here uses the word "tracing" in a sense similar to Smith's use of the word "claiming," *i.e.*, the assertion of a claim, however measured, to a thing which has already been decided to contain the value of the thing which the claimant *traced*. See Smith, *op. cit.*, 11-14.

[126] [1997] 3 All E.R. 392, 410.

[127] [1997] 3 All E.R. 392, 413. Mitchell, "Tracing trust funds into insurance proceeds," [1997] L.M.C.L.Q. 465, 473, interprets Hobhouse L.J. as holding that the claimants could not trace their funds into the policy and its proceeds, but that they were nonetheless entitled to a lien. It is rather difficult to unravel Hobhouse L.J.'s reasoning on the tracing issue. Nolan, "Our money on your life," (1997) 56 C.L.J. 491, thought that all judges had agreed that the money could be traced into the policy and its product. Chambers, *op. cit.*, 86-7, interpreted Scott V.-C. and Hobhouse L.J. as holding that the claimants could not trace their money into the policy because, if the last two or three premiums had not been paid, the cost of the insurance would have been paid for out of accumulated units. He notes that, on this reasoning, logically, the claimants should have had no rights over the proceeds. One American court denied (*obiter*) that moneys used to pay premiums could be traced into the proceeds of a life insurance policy on the ground that the proximate cause of the proceeds of the policy was the death of the insured, although the court admitted that the premiums might be traceable into the reserve or surrender value of the policy: *American National Bank of Okmulgee* v. *King*, 158 Okla. 278; 13 P. 2d 164 (1932). However, in *G. & M. Motor Company* v. *Thompson*, 567 P. 2d 80, 83 (Okla. 1977), the same court repudiated the

had little difficulty in holding that the claimants were entitled to be subrogated to the trustee's lien on the proceeds.[128] They were also entitled to a directly-imposed equitable charge in the same amount. This arose out of a right which he described as restitutionary[129] and "an equitable right to have back the wrongly applied money."[130] The equitable charge was "a mechanism by which that result can be achieved."[131] It did not extend the obligation of the recipient beyond the restitution of the money.[132] Hobhouse L.J. distinguished the claimants' right from a "full proprietary right."[133] Thus, he saw it as more limited in some way. This was not a case where the claimant beneficiaries had been part owners of the policy at the time of the payment of the premiums, or where a resulting trust could be inferred. In Hobhouse L.J.'s view, no asset had been acquired using trust funds. Rather, payments had been made for the maintenance of an existing asset (though it would not have perished in the absence of those payments).[134] Notwithstanding his apparent recognition of a limited proprietary right, Hobhouse L.J. denied that the application of the money to the premiums could confer a share in the proceeds.[135] There could be no resulting trust, as this would have to be inferred from the acts of the trustee and the defendant beneficiaries.[136] Given that the beneficiaries under the trust of the policy were innocent of any (separate) breach of trust by their trustee, there was no ground on which the claimant trustees could be entitled to a share in the proceeds of the policy.[137]

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argument advanced in the earlier case, and held that the claimant beneficiaries, in a case comparable to *Foskett* v. *McKeown*, were entitled to a proportionate share in the proceeds.

[128] Scott V.-C. had of course answered the tracing question by resort to subrogation. After that point, however, he considered the question of the extent of the claimant beneficiaries' interest without reference to a right of subrogation. Although Morritt L.J. held that the claimant beneficiaries were in fact entitled to a *pro rata* share in the proceeds, he also agreed that they could at least claim a charge by way of subrogation to the trustee's right: [1997] 3 All E.R. 392, 422.

[129] [1997] 3 All E.R. 392, 413.

[130] [1997] 3 All E.R. 392, 415.

[131] [1997] 3 All E.R. 392, 415.

[132] [1997] 3 All E.R. 392, 415. Worthington, *op. cit.*, 148, and Smith, *op. cit.*, 327, identify an enforceable right to the return of property as being a proprietary right.

[133] [1997] 3 All E.R. 392, 413.

[134] Indeed, he also held that the payment of the premiums had not increased the value of the policy, and there was therefore no increased value into which the claimants could seek to trace. While the wording of each policy must be considered individually, it may be noted that in *Holmes* v. *Davenport*, 27 Abb. N. Cas. 341, 358-9; 18 N.Y.S. 56 (1891), a court also held that a policy had been created by payment of the first premium, and had then vested in the policy beneficiaries, and could not be "divested" by later payments using the claimants' moneys. G.E. Palmer, *The Law of Restitution* (1978), § 2.15, at volume I, page 193, described this as an "untenable theory," which had later been rejected in New York: *Baxter House, Inc.* v. *Rosen*, 27 App. Div. 2d 258; 278 N.Y.S. 2d 442 (1967).

[135] [1997] 3 All E.R. 392, 414, referring to *In re Foster; Hudson* v. *Foster* [1938] 3 All E.R. 357; *In re Foster (No. 2); Hudson* v. *Foster* [1938] 3 All E.R. 610.

[136] Chambers, *op. cit.*, denies that intention is relevant to the creation of a resulting trust, arguing that it is the lack of intention to benefit the defendant which causes the resulting trust. *Cf.* Swadling, "A New Role for Resulting Trusts?" (1996) 16 Legal Studies 110, 113-7; *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669, 708 *per* Lord Browne-Wilkinson.

[137] He said (as had Scott V.-C.) that if the payments had not in fact increased the value of the asset, it would not even be subject to a charge for reimbursement in the hands of an innocent volunteer.

Morritt L.J.'s dissenting judgment was rather clearer in form. He held that the claimant beneficiaries were entitled to an equitable interest in the proceeds of the policy proportionate to the value of the premiums paid using their funds to the total amount of the premiums paid. He reached this conclusion on the basis that the claimant beneficiaries had had a proprietary interest in the moneys which were misapplied, and that this interest attached to the product of the moneys. He accepted the wording of the policy at face value, that the policy moneys were payable in consideration of all the premiums paid.[138] He treated the case as in effect one in which the claimant beneficiaries' funds had been mixed with those of the beneficiaries of the policy in order to purchase the policy.[139] Although there had been no mixing prior to the payment of the premiums, the payment of the premiums in part using the claimants' money was in itself a form of mixing.[140] Mitchell[141] favours Morritt L.J.'s conclusion, on the terms of the policy. He raises the possibility, however, that the decision of the majority might have been justifiable if the defendant beneficiaries could have established that, had they known of the trustee's misappropriations, they would have required him to pay the premiums using funds from an "untainted" source.[142]

Aside from the issue of subrogation, Scott V.-C. and Hobhouse L.J. decided to impose an equitable lien on the basis that the use of the claimants' money had improved the policy. For the same reason that they denied that the claimants' money had served to acquire the policy, it can be argued that it did not serve to improve it either - the amount of the proceeds was not increased by the third to fifth premiums (although the number of accumulated units increased).[143] The case was a contest between two sets of innocent parties. However, the claimant beneficiaries had chosen to place their money in the hands of the trustee, for the purposes of a commercial venture. They did not take security over property, nor did they insist on the provision of a bond to ensure the proper performance of the trustee's duties. The defendant beneficiaries, though volunteers, were unaware of any irregularity on the part of the trustee, and were entitled to assume that he was paying the premiums on the policy settled on them out of his own funds or out of funds properly available to him for the purpose.

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[138] [1997] 3 All E.R. 392, 421. At 424, he said that both "acquisition [of the property] and provision [of the purchase price] may occur by instalments over a period." He thought that it was therefore quite reasonable to conclude that the policy acquired with those premiums was held on resulting trust for the parties who provided the money to pay the premiums. However, as this might contradict *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234, he declined to decide the case on this point.

[139] He referred to *Scott* v. *Scott* (1963) 109 C.L.R. 649, 661-2; *In re Tilley's Will Trusts* [1967] Ch. 1179, 1189; *Edinburgh Corporation* v. *Lord Advocate* (1879) 4 App. Cas. 823, 841. Chambers, *op. cit.*, 91, is critical of Morritt L.J. for failing to explain *why* the claimants were entitled to a share of the proceeds.

[140] [1997] 3 All E.R. 392, 427.

[141] "Tracing trust funds into insurance proceeds," [1997] L.M.C.L.Q. 465, 471-2.

[142] [1997] L.M.C.L.Q. 465, 472, quoting D. Hayton, "Equity's Identification Rules," chapter 1 in P. Birks (ed.), *Laundering and Tracing* (1995), 12.

[143] Chambers, *op. cit.*, 89: "A lien is a better choice in cases of improvement or maintenance simply because assets other than the benefit received are being subjected to that property interest and a security interest is less intrusive than beneficial ownership." However, a *constructive* trust might have been appropriate if the trustee had used the money to improve his *own* property.

The author of a much earlier comment on the subject wrote as follows:

> "in many cases the investment of part of the stolen money in insurance lulls the dependents into a feeling of security, and prevents them from taking out other insurance in some legitimate way. At any rate, to give the "windfall" to the defrauded person without giving adequate consideration to the functional aspects of life insurance is to fail to evaluate the situation properly."[144]

For the reasons above-stated, it is felt that the outcome was, on balance, a just one.[145]

It seems that a claimant beneficiary's claim will be defeated if the misapplied money is paid to third parties in discharge of a debt owed to the third party.[146] It may, indeed, be wondered whether this

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[144] Comment, "Rights of a Dependent Beneficiary under Insurance Policies procured with Misappropriated Funds," (1925) 35 Y.L.J. 220, 227. Life insurance may contain elements which are intended to protect the insured or the beneficiaries against the financial consequences of death or disability, and elements which are more in the nature of an investment. It is arguable that a claimant should be permitted to claim the portion attributable to the former, but not that attributable to the latter. However, it would not be easy to apportion the two elements.

[145] A similar result was reached in *Succession of Onorato*, 219 La. 1; 51 So. 2d 804; 24 A.L.R. 2d 656 (1951). In *Baxter House, Inc.* v. *Rosen*, 27 App. Div. 2d 258; 278 N.Y.S. 2d 442 (1967), the claimant beneficiaries, whose funds had paid all the premiums, were held entitled to the entire of the proceeds. In *G. & M. Motor Company* v. *Thompson*, 567 P. 2d 80 (Okla. 1977), on facts comparable to those in *Foskett* v. *McKeown*, the court imposed a constructive trust in the proportion which the premiums paid using the claimants' money bore to the total of the premiums paid. This appears to be the majority American view: Palmer, *op. cit.*, § 2.15, and in particular, the cases cited at note 25 to volume I, page 192. In relation to the facts of *Foskett* v. *McKeown*, Chambers, *op. cit.*, 89, thinks that the defendant beneficiaries were innocent of any wrongdoing, and that the trustee's actions did not justify a constructive trust over assets which were rightfully theirs. He raises the question (at 90) whether the lien should only apply to the maximum amount of the claimants' moneys which could be traced into the policy. *In re Oatway* [1903] 2 Ch. 356 suggested not. *In re Hallett's Estate; Knatchbull* v. *Hallett* (1880) 13 Ch. D. 696 probably supports a positive answer. See also *Newell* v. *Hadley*, 206 Mass. 335, 353; 92 N.E. 507, 515 (1910). The majority view seems to be that the lien should be so limited. See Palmer, *op. cit.*, §§ 2.16-7, Smith, *op. cit.*, 265-270, and cases cited in note 75 at page 265; *James Roscoe (Bolton) Ltd.* v. *Winder* [1915] 1 Ch. 62. The rules of the Restatement of Restitution (1937), § 212 also have this effect. In *In re Hughes, A Bankrupt* [1970] I.R. 237, Kenny J. held on the facts that a solicitor had intended to replace claimants' funds when he lodged his own funds to his client account, having earlier wrongfully withdrawn client moneys.

[146] *E.g.*, *Miller* v. *Race* (1758) 1 Burr. 452 (on which, see Smith, *op. cit.*, 169-170); *Hatch* v. *Sanford*, 147 N.Y. 184, 190; 41 N.E. 403, 404 (1895); *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 142; 115 N.E. 465, 466 (1917); *Pearl-Market Bank & Trust Co.* v. *Woodward*, 22 Ohio L. Abs. 328; 1935 Ohio Misc. LEXIS 1239 (1935); *Blumberg* v. *Taggart*, 213 Minn. 39; 5 N.W. 2d 388 (1942). To the same effect is the Restatement of Restitution (1937), § 215 comment a. In *Holly* v. *Domestic & Foreign Missionary Society of the Protestant Episcopal Church in the United States of America*, 92 F. 745 (2nd Cir., 1899), the claimant beneficiary failed where the third party was also the beneficiary of a trust, of which the wrongdoer was also trustee. In *Newell* v. *Hadley*, 206 Mass. 335; 92 N.E. 507 (1910), the claimant beneficiaries were denied the right to recover the misapplied funds from the defendant beneficiaries. However, as part of the claimants' funds had been applied to the discharge of debts owed by the defendant beneficiaries, the claimants were held to have been subrogated to the former creditors' rights against the defendant beneficiaries. The court compared the case to those of invalid loans, where the money lent was applied in discharge of valid debts. See also *Bremer* v. *Williams*, 210 Mass. 256; 96

reasoning would not have applied in *Foskett* v. *McKeown*. Where the wrongdoer had caused such debts to be incurred by the defendant, without its authority, this reasoning did not apply, and the claimant was held to be entitled to recover notwithstanding the application of some of her funds to the payment of those other unauthorised debts.[147] If the misappropriated money is paid to a creditor of the claimant in discharge of a debt owed by the claimant to a third party, this is probably *pro tanto* a defence.[148]

In *Pittsburgh-Westmoreland Coal Co.* v. *Kerr*,[149] the defendant had assigned to the plaintiff the benefit of all moneys which would become payable to him under a contract, on terms that he would collect those sums and pay them to the plaintiff. In fact, the defendant used part of the funds to pay off a promissory note which he had made out in favour of a bank. The note was returned to him as paid, and he destroyed it. Chase J., on behalf of the court, said:

> "Where ... a payment with the money of another wrongfully obtained, operates to discharge a [debt] ... the debt may in equity be deemed alive for the benefit of the person whose money was so wrongfully used by the debtor and such person may be subrogated to the rights of the one who owned the debt and the debt be deemed transferred and assigned to such person."[150]

N.E. 687 (1911). In two identical decisions, a wrongdoer misappropriated funds from the defendant, and then repaid the defendant with funds misappropriated from the claimant. In each case, the defendant won, it being held that its ignorance of the earlier fraud practised on it did not mean that the later payment was not received in discharge of the wrongdoer's liability to it arising out of the earlier fraud: *London & County Banking Co. Ltd.* v. *London & River Plate Bank Ltd.* (1888) 21 Q.B.D. 535; *Nassau Bank* v. *National Bank of Newburgh*, 159 N.Y. 456; 54 N.E. 66 (1899), affirming 32 App. Div. 268 (1898). *Cf. Lyons* v. *Jefferson Bank & Trust*, 793 F. Supp. 981 (D. Colo. 1992), affirmed 994 F. 2d 716 (10th Cir. 1993), where the defendant was held to hold moneys received from the wrongdoer, which were derived from misappropriation of the plaintiff's assets, on constuctive trust for the plaintiff. However, the defendant had omitted to plead the defence that it was a *bona fide* purchaser for value without notice: see Smith, *op. cit.*, 306 and note 57. In *Fidelity & Casualty Company of New York* v. *Maryland Casualty Company*, 222 Wis. 174, 180; 268 N.W. 226 (1936), the trustee had misappropriated funds of the respondent estate, and had then paid legacies which were a claim on that estate with funds misappropriated from the claimant estate. The surety who was liable to pay and had paid the beneficiaries of the claimant estate in respect of the defaults of the trustee on their estate was held to have been subrogated to the recipient beneficiaries' rights against the trustee and the defendant surety who was liable to indemnify them. The question was: which surety should bear the loss? It appears that it could only be answered in principle by deciding which estate would have borne the loss, but for the presence of the sureties. Since the misappropriated moneys had been received in good faith in the discharge of legacies which were a claim on the estate of the recipient trust, it is felt that the claimant beneficiaries (and in this case, their surety) should have borne the loss. Where a trustee misappropriated property which he held on trust, and pledged it as security for a loan made to him as trustee for a second trust, he not having authority to borrow on behalf of the second trust, and the beneficiary of the second trust later paid back the loan and obtained an assignment of the property, it was held that the beneficiary had effectively obtained only the equity of redemption in the said property, and was not a purchaser for value: *Jones* v. *Swift*, 300 Mass. 177; 15 N.E. 2d 274 (1938).

[147] *Chapple* v. *Merchants National Bank*, 284 Mass. 122, 143; 187 N.E. 232, 237 (1933).

[148] *B. Liggett (Liverpool) Ltd.* v. *Barclays Bank Ltd.* [1928] 1 K.B. 48; *Smith* v. *Knapp*, 297 Mass. 466, 471; 9 N.E. 2d 399 (1937). See *ante*.

[149] 220 N.Y. 137, 142; 115 N.E. 465, 466 (1917).

[150] 220 N.Y. 137, 142; 115 N.E. 465, 466-7 (1917).

In a case where the original creditor had no notice of the beneficial ownership of the money applied in part payment of the debt, it was held that the beneficial owner was not entitled to subrogation, it being assumed that the case was a contest between two innocent parties, the beneficial owner having been careless in placing its confidence in the misappropriating agent.[151] It is not at all clear why the case should have been so regarded, unless the case can be explained as an application of the rule denying subrogation in cases of part payment.[152] Certainly, no mention was made of that rule.

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[151] *Pearl-Market Bank & Trust Co.* v. *Woodward*, 22 Ohio L. Abs. 328; 1935 Ohio Misc. LEXIS 1239 (1935).
[152] See *ante*.

PART III

PERSONS ENTITLED TO SUBROGATION

SPECIFIC CASES

CHAPTER 7

SUBROGATION OF SURETIES AND CO-DEBTORS

7.1 Introduction

From an early date, actions by sureties or "pledges" against a principal debtor for an indemnity were recognised by the common law courts.[1] Virtually all of these cases seem to have proceeded on an express contract of indemnity, and, indeed, it came to be thought that the surety required a *specialty*, or counter-bond of indemnity, in order to succeed.[2] Certainly by the fifteenth century, equity enforced the surety's right to an indemnity without a specialty, and even without any express contract of indemnity.[3] By the eighteenth century, the common law courts had adopted a similar jurisdiction, by means of the action for money paid.[4]

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[1] Glanvill, *A Treatise on the Laws and Customs of the Kingdom of England* (late twelfth century; translation by J. Beames, 1812), 10.4, at 250. See also R. Van Caenegem, *Royal Writs in England from the Conquest to Glanvill* (1959) 77 Selden Society, at 256, note 1. In *Hindes* v. *Norh.'* ((1205), 3 *Curia Regis Rolls*, at 298 (Pasch. 6 & 7 John, Roll 38)), a surety claimed against a principal debtor who had defaulted, thereby causing him loss. The plea is referred to as one of suretyship: "de placito plegiagii." Early cases in the Irish justiciar's court include *Unred* v. *Beg* (1295) 1 Calendar of Justiciary Rolls of Ireland 15, *le Blond* v. *de Rupe* (1295) 1 Calendar of Justiciary Rolls of Ireland 16, *London* v. *Cristofre* (1297) 1 Calendar of Justiciary Rolls of Ireland 118, *Perceval* v. *Speresholt*, *ibid*, *Coytrot* v. *le Mareschal and Fautyuel* (1302) 1 Calendar of Justiciary Rolls of Ireland 429 and *Petit* v. *Brun* (1309) 3 Calendar of Justiciary Rolls of Ireland 137.

[2] Holmes, "Early English Equity," (1885) 1 L.Q.R. 162, 171-2; Kiralfy, "History of the Law of Personal Guarantee (Suretyship) in England since 1500," (1971) 29 Receuils de la Société Jean Bodin pour l'histoire comparative des Institutions 399, 406. An example where a surety had taken a specialty is *Wroteham* v. *Canewold* (1311) Y.B. 4 Edw. II (Selden Society) 147. See also W.T. Barbour, *The History of Contract in Early English Equity*, (1914) 4 Oxford Studies in Social and Legal History, 133. In (1374) Y.B. M. 48 Edw. III, f. 29, pl. 15, Kirton J. stated that the surety's (or "pledge's") recourse had to be by action of covenant (*i.e.*, on a specialty). A. Fitzherbert, *The New Natura Brevium*, 137C, argued that a specialty was not needed, on the unhistorical ground that the surety's action derived from chapter 9 of *Magna Carta*. As the surety could have brought his action with a deed prior to that Act, it would have been ineffectual unless it were understood as allowing him to sue without a specialty. However, the surety's action without a deed existed prior to *Magna Carta*. See E. Shanks and S.F.C. Milsom (eds.), *Novae Narrationes*, (1963) 80 Selden Society, clxix: "[b]ad history can make a tolerable argument." Note also J.H. Baker, *Assumpsit for Nonfeasance*, (1979) 94 Selden Society, 282.

[3] See Barbour, *op. cit.*; Ibbetson, "Unjust Enrichment in England before 1600," in E.J.H. Schrage (ed.), *Unjust Enrichment, The Comparative History of the Law of Restitution* (Comparative Studies in Continental and Anglo-American Legal History, Band 15, Berlin, Duncker & Humblot, 1995), at 121, 146, giving further examples. He does state that "[t]he contours of the obligation to indemnify, like those of the obligation to make contribution, were essentially contractual."

[4] *Morrice* v. *Redwyn* (1731) 2 Barn. K.B. 26. In *Woffington* v. *Sparks* (1754) 2 Ves. Sen. 569, doubt had been expressed in Chancery as to whether the surety could have had any right at common law. See also *Decker* v. *Pope* (1757) in Selwyn, *An Abridgement of the Law on Nisi Prius* (10th ed., 1842) 72 n., *per*

In the modern age, express contracts for indemnity are not uncommon. Where there is no express contract, the basis for the surety's undoubted right to indemnification may differ from case to case. Where the surety undertakes his obligation at the request of the principal, it is quite appropriate to imply a contractual term to the effect that the principal will indemnify the surety.[5] However, the right to indemnification exists independently of contract. While the right was often described as a quasi-contractual one, there may be difficulties in fitting it into a framework of the reversal of unjust enrichment. The theoretical difficulty is that, as will be seen, the surety is entitled to recover the full amount of his loss, including interest, costs properly incurred, and any additional loss or expense.[6] The principal cannot be said to have been "enriched" by these sums.[7]

The surety's payment does have the effect of discharging the liability of the principal debtor, and it is therefore accurate to say that the principal debtor is enriched to that extent, but for the action which the surety has against him.[8] In Roman law, it was said that, while the effect of payment would ordinarily be to discharge the debt, where the surety requested a transfer, the transaction would be treated as in effect a sale, the sum paid by the surety being the purchase price.[9] This was, of course, a fiction.[10]

Lord Mansfield and the other judges of the King's Bench; *Toussaint* v. *Martinnant* (1787) 2 T.R. 100, 105; *Powell* v. *Smith*, 8 Johns. 249, 252 (N.Y. 1811). *Cf. O'Brien* v. *Irwin* (1794) Ridg., Lapp & Sch. 361.

[5] *Anson* v. *Anson* [1953] 1 Q.B. 636, 641. *Cf. In re A Debtor (No. 627 of 1936)* [1937] 1 Ch. 156, 165 *per* Greene L.J. Also, *Wright* v. *Hunter* (1800) 5 Ves. 792, 793 *per* Arden M.R.: "a partnership creates an agreement, that in case any partner pays more than his share, the others shall indemnify him" and J. Phillips and J. O'Donovan, *The Modern Contract of Guarantee* (2nd ed., 1992), 501.

[6] See C. Mitchell, *The Law of Subrogation* (1994), 55; S. Eiselen and G. Pienaar, *Unjustified Enrichment: A Casebook* (1993), 280, note (a).

[7] Eiselen and Pienaar, *loc. cit.*:

> "The action for compensation based on *negotiorum gestio* must be distinguished from *negotiorum gestorum utilis* ... as an enrichment action. In terms of *negotiorum gestio* the *gestor* voluntarily administers the affairs or acts in the interest of the *dominus* without the latter's consent or authorization. In Roman and Roman-Dutch law *negotiorum gestio* was classified as a quasi-contractual action. It is submitted that in the South African law it should be described as an action *sui generis* based on equity, because the action is not based on contract or on agreement ... It is also not an enrichment action, because all reasonable expenses by the *gestor*, and not enrichment, are taken into account to determine compensation."

P. Birks, *An Introduction to the Law of Restitution* (1985, rev. ed. 1989), 186, asserts that the principal debtor is enriched by the discharge of his liability, which is incontrovertibly beneficial to him. In other words, it was inevitable that, but for the surety's payment, the principal debtor would have had to pay.

[8] See section 2.4, *ante*.

[9] D. 46.1.36 (Paul).

[10] M. Pothier, *Coutumes des Duché, Baillige et Prévoté d'Orléans, et ressort d'iceux* (in M. Dupin (ed.), *Oeuvres de Pothier*, X (1827)), n° 67; M. Pothier, *A Treatise on the Law of Obligations or Contracts* (translation, W.D. Evans, 1806), I, n° 520 (quoted with approval by Tucker P. in *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588, 601 (1837)); Kames, *op. cit.*, 12; Dixon, *op. cit.*, 5, 68. *Cf.* Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), 135:

> "to object to the unrealistic nature of the argument does not seem entirely fair; for the characteristic feature of a fiction is that it deals with a particular set of facts as if a different set of

Under Roman law, the surety could not avail of the right to the transfer of the creditor's securities unless he had contracted for it or requested it at or prior to the time of payment.[11] A succession of authors argued in favour of the validity of an assignment of the creditor's rights against the principal even after payment by the surety.[12] Later legal systems have come to see subrogation as occurring automatically.[13] In common law systems, it was never doubted in modern times that the surety had a personal action for indemnification. However, since his payment discharged the debt which the principal owed to the creditor, it was thought at one time that this discharge extinguished some or all of the securities which the creditor held against the principal debtor.[14]

This perceived obstacle was overcome by a statutory provision[15] which has since been repealed in Ireland,[16] though without affecting existing principles, rules of law or equity, or established jurisdictions, notwithstanding that they derive from the repealed Act.[17] A question may therefore exist whether, and to what extent, the Irish law has reverted to the prior position.[18]

Mitchell[19] postulates that, since the principal debtor would otherwise be unjustly enriched, the debt which he owed is "revived" by law and transferred to the surety. However, Mitchell acknowledges that the quantum of the surety's recovery is not measured by the enrichment of the principal debtor.[20]

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facts were at issue. Also, the Roman lawyers always seem to have been aware of the fictitious nature of this purchase contract and were not led to inappropriate consequences and distortions." [citation omitted]

[11] D. 46.3.76 (Modestinus). This was in the case of one who was bound as a *fideiussor*. If one were a *mandator*, a cession could still be valid if made after payment, as the *mandator*'s obligation would be regarded as distinct from that of the "principal." Note also Dixon, *op. cit.*, 45, 63, 65

[12] Bartolus of Saxoferrato (1314-1357), *Commentaria in Digestum vetus, Infortiatum, Digestum novum*, at D. 46.3.76 (Modestinus) (entitled D. 46.3.75), at para. 4; Joannis à Sande, *Commentary on the Cession of Actions*, 7.11, in *Opera Omnia Juridica Joannis et Frederici à Sande Jurisconsulti Clarissimorum* (Antwerp, 1674). The argument was that if the surety paid on his own behalf, only his own obligation would be extinguished; in effect, it was argued that the obligation of a surety was distinct from that of the principal. J. Voet, *Commentary on the Pandects* (translated by P. Gane, *sub tit.* "*The Selective Voet, being the Commentary on the Pandects*," VII, 1957, 56-60), 46.1.30, convincingly showed that this was an incorrect view on the basis of authority and logical exegesis upon the classical sources. However, he proposed that the courts should permit such an assignment after payment by the surety, this being "more in accordance with the simplicity of our customs."

[13] See, *e.g.*, *Fleming* v. *Beaver*, 2 Rawle 128, 132; 19 Am. Dec. 629, 631 (Pa. 1828). *Cf.* Dixon, *op. cit.*, 51-2, 80-1 and 175, who was critical of this view.

[14] *Copis* v. *Middleton* (1823) Turn. & R. 224. See further, *post*.

[15] Mercantile Law Amendment Act 1856 (19 & 20 Vict., c. 97), section 5.

[16] Statute Law Revision Act 1983, section 1 and First Schedule, Part IV.

[17] Section 2(1).

[18] See *post*.

[19] *Op. cit.*, 52-3.

[20] *Op. cit.*, 55 and note 19. In *Etter* v. *Industrial Valley Bank and Trust Co.*, 515 A. 2d 6 (Pa. Super. 1986); *allocatur* denied 524 A. 2d 494 (Pa. 1987), the court stated *both* that a surety's right of reimbursement was limited to the amount which it reasonably paid out to satisfy its obligation, *and* that

Also, the revival which he describes occurs at least in part as a result of statute. The purpose of the provision was undoubtedly to better the position of the surety. However, there is no other reason why its operation must be characterised as intended to reverse an unjust enrichment.[21] Mitchell is critical of the effect of the statute and of case law which permits the surety to avail of securities held by the creditor against the principal debtor.[22] He regards this as the elevation of the surety's claim to a proprietary level, without adequate justification.

7.2 The Extent of the Surety's Recovery

The surety is entitled to a complete indemnity from the principal debtor. If the surety pays the creditor in kind, he is entitled to recover the value of the payment at the time of payment. In *Badeley* v. *Consolidated Bank*,[23] Stirling J. said

> "I take it that if a surety could prove that by reason of the non-payment of the debt he had suffered damage beyond the principal and interest which he had been compelled to pay, he would be entitled to recover that damage from the principal debtor."

It will be seen that the extent of the surety's recovery may exceed the benefit conferred on the principal, *i.e.*, the amount of the debt which the surety has paid.[24] In France, a voluntary surety is entitled to reimbursement from the principal debtor.[25] One author, noting that the question has not been addressed in case law, offers the view that in such a case, the surety's recourse is founded on the management of the principal's affairs, and therefore that the surety is only entitled to recover from the principal the amount by which the principal benefited (*i.e.*, the amount of his debt which the surety paid, with interest which

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the surety's right of recovery existed in order to prevent an unjust enrichment, without recognising the potential for contradiction between the two statements.

[21] Or to prevent an unjust enrichment, which Mitchell envisages as being the function of "simple" subrogation, as in the case of insurers: *op. cit.*, 10: "Given that the rationale underlying the award of simple subrogation is the prevention of unjust enrichment, though, and given also that the guiding principle of the law of restitution is the reversal of unjust enrichment, it may at least be said that the remedy's proper place is alongside the law of restitution, if not squarely within it." For the purposes of the present work, the assumptions encapsulated in the expressed rationale and in the use of the word "award" are questioned.

[22] *Op. cit.*, 59-60.

[23] (1886) 34 Ch. D. 536, 556, affirmed (1888) 38 Ch. D. 238.

[24] *Cf.* S. Eiselen and G. Pienaar, *Unjustified Enrichment: A Casebook* (1993), 280, note (a), quoted *ante.* See also K.P. McGuinness, *The Law of Guarantee* (1986), para. 11.21 (at 322): "where a person has suffered a loss or expense because of the default or miscarriage of another person, a general right of indemnification is recognized, even though no one can be said to have derived a benefit in the circumstances," referring to *Bigelow* v. *Powers* (1911) 25 O.L.R. 28 (C.A.); *Necula* v. *Ducharne* (1963) 38 D.L.R. (2d) 736 (Alta. T.D.).

[25] Article 2028 of the Civil Code. See P. Simler, *Cautionnement et Garanties Autonomes* (2nd ed., Éditions Litec, Paris, 1991), n° 529.

the creditor would have been entitled to charge him).[26] A similar argument has been advanced in relation to the common law.[27]

As in all other instances of subrogation, the surety cannot recover from the principal debtor more than he has himself paid to the creditor, together with his costs of the earlier proceedings, and interest.[28] Lord Cottenham explained the rule on the ground that the surety had taken on himself the obligation to pay or settle the debt. If he did so at a discount, he was bound to treat this as payment, rather than as a purchase of the debt from the creditor. In effect, the surety is treated almost as if he has a form of fiduciary duty to the principal, such that he is not allowed to make a profit at the principal's expense.[29] This again demonstrates that the extent of the surety's recovery is not measured by the extent of the benefit or enrichment conferred on the principal debtor. If the surety settles the creditor's claim, he will be entitled to recover the amount of the settlement from the principal. In a case where the surety settled the claim without giving notice of the creditor's claim upon him to the principal debtor, it was held that the principal was entitled to adduce evidence to the effect that the surety could have settled the claim on better terms.[30]

7.2.a Interest

Since the surety is entitled to an indemnity from the principal debtor, he is entitled to interest on the amount he has paid up until the time when he is himself paid. His entitlement does not rest upon contract.[31] A number of examples may be given. In *Petre* v. *Duncombe*,[32] a surety sued the principal under an express covenant of indemnity, which made no mention of interest. The surety was held entitled

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[26] Simler, *loc. cit.*

[27] Phillips and O'Donovan, *op. cit.*, 500-1.

[28] *Ex parte Rushforth* (1805) 10 Ves. 409, 422 *per* Lord Eldon L.C.; *Butcher* v. *Churchill* (1808) 14 Ves. 567, 576; *Reed* v. *Norris* (1837) 2 My. & Cr. 361, 375 *per* Lord Cottenham L.C. (so even in a case where the surety had obtained an assignment of the entire debt).

[29] *Reed* v. *Norris* (1837) 2 My. & Cr. 361, 375.

[30] *Ince* v. *Sampson*, unreported, Supreme Court of New South Wales, Equity Division, Young J., 27th September 1991, 1991 N.S.W. LEXIS 9147; BC 9101532, at *26. In such a case, presumably, the principal could have settled the debt on those terms, and thus, that sum only is the amount of the enrichment to him. If the surety gives notice to the principal, who takes no action, then the principal is estopped from disputing the propriety of the settlement: *Duffield* v. *Scott* (1789) 3 T.R. 374; *Smith* v. *Compton* (1832) 3 B. & Ad. 407, 408-9; *Parker* v. *Lewis* (1873) L.R. 8 Ch. App. 1035, 1059 *per* Mellish L.J. *Cf. Stimpson* v. *Smith* [1999] 2 W.L.R. 1292, 1300 *per* Peter Gibson L.J., acknowledging that if one co-surety paid without the prior consent of the other co-surety, there being no court order holding the latter liable, the latter co-surety would be free to argue that the payment was officious or voluntary, and that he was not therefore liable to contribute towards it.

[31] To the contrary is *Copis* v. *Middleton* (1823) Turn. & R. 224. In *Onge* v. *Truelock* (1831) 2 Moll. 31, 43, Sir Anthony Hart C. said that the disallowance of interest in *Copis* v. *Middleton* seemed very hard, and but for that decision, he would have regarded a surety as entitled to interest as against the principal.

[32] (1851) 20 L.J.Q.B. 242, 244; 2 Lown. Max. & Poll. Pr. Cas. 107.

to interest as damages against the principal.[33] In *Scottish Provident Institution* v. *Conolly*,[34] Porter M.R. held that the trustees of an estate which was secondarily liable to pay annuities were entitled to recover the principal sum and interest for six years (the limitation period) from the estates which were primarily liable. Even if the annuities did not carry interest, the secondarily liable estate was entitled to an indemnity, which indicated that it was entitled to interest.[35]

7.2.b Costs

A surety is entitled to reimbursement of costs it incurs in resisting the creditor's claim.[36] However, if the costs were unreasonably incurred, as in mounting an unmeritorious defence, the surety may not be permitted to charge the principal with these.[37] In *Bredin* v. *Reade*,[38] a surety in a recognisance for a receiver was allowed certain of his costs of defending proceedings brought against him, together with *interest on those costs*. If the surety has to pay the creditor's costs, he will be entitled to recover these

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[33] See also *Parsons* v. *Briddock* (1708) 2 Vern. 608; *Lawson* v. *Wright* (1786) 1 Cox 275; *Executors of Fergus* v. *Gore* (1803) 1 Sch. & Lef. 107; *Butcher* v. *Churchill* (1808) 14 Ves. 567, 576; *In re Swan's Estate* (1869) I.R. 4 Eq. 209; *In re Fox, Walker & Co.* (1880) 15 Ch. D. 400. In *Willes* v. *Greenhill* (1860) 30 L.J. Ch. 808, the executors of a testator, who was surety for his son in promissory notes made by the son, were held entitled to be repaid the sum so paid by them on the notes, with the interest which had accumulated on the sum due on the notes, together with the costs of the proceedings brought by the creditor against them, out of a legacy which the testator had bequeathed to the son. The testators were only entitled to deduct the interest which the notes would have borne, and not the (higher) interest which they were liable to pay to a bank which had advanced the necessary funds for the payment of the creditor. In *Bredin* v. *Reade* (1828) 1 Law Rec. (o.s.) 482, the surety in a recognisance for a receiver was held entitled to recover the amounts he had paid on foot of orders of the court, with interest thereon. See also *Mara* v. *Ryan* (1838) 2 Jones 715, 718.

[34] (1893) 31 L.R. Ir. 329.

[35] In *In re Evans. Ex parte Davies* (1897) 66 L.J.Q.B. 499; 41 S.J. 494, Vaughan Williams J. admitted a proof by a surety in the principal's bankruptcy for principal and interest where principal and surety had each been bound in a promissory note, and the surety had paid. The entitlement to interest was said to arise as the debt had arisen by virtue of a written instrument, to the benefit of which the surety had been subrogated under section 5 of the Mercantile Law Amendment Act 1856. In *Employers Liability Assurance Corporation Ltd.* v. *The Queen* [1969] 2 Ex. C.R. 246, a surety in performance and payment bonds was held entitled to interest on contract retention funds held by the owner. The contractor would have been entitled to such interest if it had completed and the owner had wrongfully refused to release the funds.

[36] *Parsons* v. *Briddock* (1708) 2 Vern. 608; *Duffield* v. *Scott* (1789) 3 T.R. 374; *Beech* v. *Jones* (1848) 5 C.B. 696; *Hornby* v. *Cardwell* (1881) 8 Q.B.D. 329; *In re Russell; Russell* v. *Shoolbred* (1885) 29 Ch. D. 254, 259 (*per* Kay J.); 266 (*per* Fry L.J.). Under Roman law, if the guarantor properly incurred expenses in his function, he was entitled to recover these from the principal: D. 17.1.45.6 (Paul), and H. Grotius, *The Jurisprudence of Holland*, translation by R.W. Lee (1924), 3.3.21.

[37] *Cf. Smith* v. *Howell* (1851) 6 Ex. 370. In *Heyman* v. *Dubois* (1871) L.R. 13 Eq. 158, the surety was allowed the costs of defending proceedings brought by the creditor. As to the surety's right to seek a contribution towards his costs from co-sureties, see *Wolmershausen* v. *Gullick* [1893] 2 Ch. 514.

[38] (1828) 1 Law Rec. (o.s.) 482.

from the principal as well,[39] at least where the surety did not unjustifiably increase the amount of those costs by an unmeritorious defence.[40] He cannot recover costs attributable to his own default.[41]

7.3 The Surety's Right to Contribution from Co-sureties

Whereas the insurer's right to contribution from co-insurers is a direct one only, and cannot be enforced by subrogation to the rights of the insured, the surety can be subrogated to the creditor's rights against co-sureties. This was one of the earliest applications of the *beneficium cedendarum actionum* in the civil law. It was recognised by equity since the seventeenth century at least.[42] It was codified by the repealed section 5 of the Mercantile Law Amendment Act 1856.[43] The earlier cases tended to concern sureties bound together in a joint or joint and several bond. It was later established that the right to contribution did not depend upon any contractual privity between the co-sureties, but upon the equitable principle of equality of burden among persons similarly bound.[44] Lord Redesdale explained the basis of the right as follows:

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[39] *E.g.*, *Jones* v. *Brooks* (1812) 4 Taunt. 464; *Mott* v. *Hicks*, 1 Cowen 513, 539-540 (N.Y. 1823) *per* Sutherland J.; *Stratton* v. *Mathews* (1848) 3 Ex. 48, 49 *per* Parke B.; *Willes* v. *Greenhill* (1860) 30 L.J. Ch. 808.

[40] *In re International Contract Co.* (1872) L.R. 13 Eq. 623, 624 *per* Wickens V.-C.

[41] So, where a surety's first intimation of the creditor's claim against him was the receipt of legal proceedings, and he then permitted judgment to be obtained against him by default for principal and costs, he was permitted to recover from the principal debtor the creditor's costs of the writ, but not the other costs which he had paid to the creditor, as he should have paid the creditor promptly upon notice of the claim, which would have obviated the incurring of those costs: *Pierce* v. *Williams* (1854) 23 L.J. Exch. 322.

[42] There are records of bills on the Equity side of the Court of Exchequer praying a contribution toward crown debts as far back as the sixteenth century at least: *Whalley* v. *Mounson* (1553-4) E. 111/46-E; *Kirkham* v. *Taverner* (1554-8) E. 111/46-C, referred to in W.H. Bryson, *The Equity Side of the Exchequer* (1973), 10, note 2. An early case of contribution in the Chancery is *Clarke* v. *Hunlock* (1626) Tothill 179, so briefly reported that one can make little of it. See, later, *Peter* v. *Rich* (1629-30) 1 Rep. Ch. 34; *Fleetwood* v. *Charnock* (1629-30) Nelson 10; Tothill 41; *Morgan* v. *Seymour* (1637-38) 1 Rep. Ch. 120 (on which, see Marasinghe, "An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine I," (1976) 10 Valparaiso L. Rev. 45, 56-7); *Swain* v. *Wall* (1641-42) 1 Rep. Ch. 149; *Hole* v. *Harrison* (1675) Rep. *temp.* Finch 203; 1 Ch. Ca. 246; 1 Rep. Ch. 15, 203; *Waller* v. *Dalt* (or *Dale*) (1676 or 1677) Rep. *temp.* Finch 295; Dickens 8; 1 Eq. Ca. Abr. 90; 1 Ch. Ca. 276.

[43] 19 & 20 Vict., c. 97.

[44] *Dering* v. *Earl of Winchelsea* (1787) 1 Cox 318; 2 Bos. & P. 270 (three sureties each bound in separate bonds with the principal debtor); *Craythorne* v. *Swinburne* (1807) 14 Ves. 160; *Dalton* v. *Robins* (1836) 4 Law Rec. (n.s.) 240 (sureties in separate recognisances entitled to contribution from each other); *Rae* v. *Rae* (1857) 6 Ir. Ch. R. 490, 494-5; *Chipman* v. *Morrill*, 20 Cal. 130, 135 (1862); *Gardner* v. *Brooke* [1897] 2 I.R. 6, 12 *per* O'Brien J.: "The principle came into the English from the Civil law where it pursues exactly the same consequences and distinctions that are found in equity, all based on community of burthen and benefit from payment, and none from agreement." In the same case at 19, Gibson J. stated that at common law, co-debtors could sustain an action for contribution against each other on the "implied *assumpsit* and request flowing from the common liability." He acknowledged that the equitable right of contribution was independent of contract. See also *Stimpson* v. *Smith* [1999] 2 W.L.R. 1292, 1298 *per* Peter Gibson L.J.; 1304 *per* Tuckey L.J. J. Story, *Commentaries on Equity Jurisprudence* (13th ed., M. M. Bigelow, 1886), § 499, compared the surety's right to contribution to the doctrine of marshalling:

> "If several persons are indebted, and one makes the payment, the creditor is bound in conscience, if not by contract, to give to the party paying the debt all his remedies against the other creditors. The cases of average in equity rest upon the same principle. It would be against equity for the creditor to exact or receive payment from one, and to permit, or by his conduct to cause, the other debtors to be exempt from payment. He is bound, seldom by contract, but always in conscience, so far as he is able, to put the party paying the debt upon the same footing with those who are equally bound."[45]

In situations where a surety is aware that others are bound or are likely to be bound in the same degree, the right may be regarded as deriving from an implied contractual term.[46]

Although a co-surety or co-debtor paying more than his share of the common debt will be substituted to the benefit of the creditor's rights against his fellow sureties or debtors once the creditor has

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> "This indeed is but an illustration of a much broader doctrine established by Courts of Equity; which is that a creditor shall not, by his own election of the fund out of which he will receive payment, prejudice the rights which other persons are entitled to; but they shall either be substituted to his rights, or they may compel him to seek satisfaction out of the fund to which they cannot resort."

As an example, one may note the case of *Goree* v. *Marsh* (1690) 2 Freem. 113, where the court indicated that, if a creditor had claims on two funds, but another a claim on one alone, the former "ought not to be chancellor, so as to be under his power whether the debts should be paid or not, so long as he is not at any prejudice, but must have a satisfaction."

[45] *Stirling* v. *Forrester* (1821) 3 Bli. 575, 590-1, approved in *Duncan, Fox & Co.* v. *North and South Wales Bank* (1880) 6 App. Cas. 1, 19 (*per* Lord Blackburn); *Ward* v. *National Bank of New Zealand* (1883) 8 App. Cas. 755, 765 (P.C.). In *Ahern* v. *McSwiney* (1874) 9 I.L.T.R. 13, 14, Christian L.J. referred to the surety's right of contribution as an equity "superinduced" on a contract. In *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669, 727, Lord Woolf referred to the surety's "equitable right of contribution" as "an application of an equitable approach to restitution to a situation where the remedy at law is not normally satisfactory."

[46] *Craythorne* v. *Swinburne* (1807) 14 Ves. 160, 169, 171 *per* Lord Eldon L.C.: "this obligation of co-sureties is not founded in contract: but stands upon a principle of equity; and Sir Samuel Romilly has very ably put, what is consistent with every idea, that, after that principle of equity has been universally acknowledged, then persons, acting under circumstances, to which it applies, may properly be said to act under the head of contract, implied from the universality of that principle. Upon that ground stands the jurisdiction assumed by Courts of Law ... [The doctrine of contribution] stands upon this; that 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; that equality is equity; and, if he will not make them contribute equally, this Court will finally by arrangement secure that object." See also *Aiken* v. *Peay's Executors*, 5 Strobhart's Law 15; 53 Am. Dec. 684, 685 (S.C. 1850) *per* Evans J. (the obligation to contribute is "an implication of law arising out of their undertaking"); *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205, 207; *Newton* v. *Chorlton* (1853) 10 Hare 646, 650-1; 2 Drew. 333n.; *Chipman* v. *Morrill*, 20 Cal. 130, 135 (1862) *per* Field C.J. ("the equitable doctrine, in progress of time, became so well established, that parties were presumed to enter into contracts of suretyship upon its knowledge"); *Gardner* v. *Brooke* [1897] 2 I.R. 6, 16-18 *per* Johnson J.; 20 (C.A.); *Scholefield Goodman and Sons Ltd.* v. *Zyngier* [1986] 1 A.C. 562.

been paid in full, his right to contribution nonetheless exists independently of subrogation, and may arise prior to the complete satisfaction of the creditor.[47]

7.3.a When Contribution is available

A co-surety or co-debtor will only be entitled to contribution from a party which is liable to answer for the debt in the same degree as the payer. So, if the defendant's liability is considered in law to be prior to that of the plaintiff payer, the plaintiff will be held entitled to a full indemnity, and to subrogation to the creditor's rights in order to enforce that right. If the defendant's liability is subsequent to that of the plaintiff, then the *defendant* will be entitled to full indemnification from the plaintiff.[48] Issues as to the order of liability are particularly apt to arise in cases concerning successive parties to negotiable instruments, or guarantees of the liability of parties to negotiable instruments. In general, successive indorsers of a bill of exchange or promissory note are liable in the order of their signature, rather than being co-sureties.[49] However, the true order of liability, if otherwise, may be shown.[50] In *Turner* v. *Davies*,[51] a surety who had become such at the instance of another surety was held to be a surety

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[47] See, *e.g.*, *Gardner* v. *Brooke* [1897] 2 I.R. 6, 19 *per* Gibson J.: "Is it an unqualified liability, according to the proportionate shares of each, to indemnify any joint maker who may at any time be legally compelled to pay more than his share? or does the duty depend on the co-debtor, who has paid in excess of his share, being merely subrogated into the creditor's rights?... The first view is, I think, plainly the true one." See also *Barry* v. *Moroney* (1873) I.R. 8 C.L. 554, reversing (1872) I.R. 7 C.L. 110, 112 *per* Lawson J., assuming that the right to contribution rests on an implied request. In *Stimpson* v. *Smith* [1999] 2 W.L.R. 1292, the liability of the two co-sureties to the creditor was limited. When the plaintiff surety settled the creditor's claim against him, he was held entitled to claim contribution from his co-surety, although he had not paid the entire of the creditor's debt.

[48] See, *e.g.*, *Rae* v. *Rae* (1857) 6 Ir. Ch. R. 490.

[49] *Macdonald* v. *Whitfield* (1883) 8 App. Cas. 733; *McDonald* v. *Magruder*, 3 Peters 470 (U.S. 1830); *Aiken* v. *Barkley*, 2 Speers' Law 747; 42 Am. Dec. 397 (S.C. 1844); *Bank of the United States* v. *Beirne*, 1 Grattan 234; 42 Am. Dec. 551 (Va. 1844); *McCarty* v. *Roots*, 21 Howard 432 (U.S. 1858); *Chrisman's Administratrix* v. *Harman*, 29 Grattan 494; 26 Am. Rep. 387 (Va. 1877).

[50] Thus, where three indorsers had agreed among themselves to be co-sureties in the same degree, they were each liable to contribute equally to the payment of the bill: *Macdonald* v. *Whitfield* (1883) 8 App. Cas. 733. See also *Gardner* v. *Brooke* [1897] 2 I.R. 6, 15 *per* Johnson J. If a number of persons sign their names to an instrument prior to its being discounted, it seems that they will not be presumed to have assumed liability as indorsers in order of signature; rather, it will be presumed that they all intended to be sureties to the holder in the same degree: *Reynolds* v. *Wheeler* (1861) 10 C.B. (n.s.) 561; *Macdonald* v. *Whitfield* (1883) 8 App. Cas. 733, 749-50 (P.C.). In *Warner* v. *Price*, 3 Wendell 397 (N.Y. 1829), a bank refused to discount a note signed by the principal debtor and three sureties unless another surety was added. A fourth person signed expressly as a surety. One of the three original sureties admitted that the fourth signatory had signed as surety for all prior signatories. Nonetheless, the fourth person was held to be a co-surety with the first three in the same degree. Savage C.J. held that all the signatories, with the exception of the principal, had to be considered to be sureties in the same degree, unless it could be shown positively or by necessary implication that all of the first three sureties intended to be in the position of principals with regard to the latter signatory. A similar decision was *Beaman* v. *Blanchard*, 4 Wendell 432 (N.Y. 1830), in which B. applied to A. to lend his name as a maker to a promissory note for B.'s benefit, stating that it would be signed by B., and C. and D. It was held that A., C. and D. were co-sureties in the same degree.

[51] (1796) 2 Esp. 478.

for that surety.[52] Some English cases take the view that several and successive parties to negotiable instruments should be presumed to be bound in the same degree.[53]

Where a number of parties are liable successively, one whose liability is prior to that of another cannot attempt to shift the burden of the debt onto the latter, either by means of subrogation or assignment. Thus, in a Scottish case,[54] one party had guaranteed the payment of bills of exchange by the acceptor. Although he had received an assignment of the bills from the holder (creditor), it was held that he was not entitled to recover any sum from the estate of an indorser. As the guarantor had intervened to guarantee payment by the acceptor, his liability must have been prior to that of the indorser.[55]

A far more recent Privy Council decision on an Australian appeal is irreconcilable with the Scottish case. In *Scholefield Goodman and Sons Ltd.* v. *Zyngier*,[56] a party ("Z.") had guaranteed the indebtedness of the acceptor of bills of exchange to the holder of the bills.[57] The acceptor dishonoured the bills on presentation by the holder. The drawer of the bills, whose liability was subsequent to that of the acceptor, paid the holder, and then claimed a contribution from the guarantor, Z., and claimed that it had been subrogated to the holder's rights against Z. Z. argued that under her guarantee, she was liable only if the bill was not paid by any of the parties to it, and that her liability was therefore subsequent to that of the drawer. The mortgage under which Z. undertook her liability provided that she covenanted to pay the holder, *inter alia*, any sum which might become payable by the acceptor in respect of any bills of exchange to which the acceptor might become a party, either primarily or only in the event of any other person failing to pay them, as well as any other sums due from the acceptor to the holder.

Fullager J. concluded that, on the proper construction of the mortgage, Z. was a surety for the performance of their obligations by all parties liable on the bills.[58] Therefore, Z. had no liability to contribute to the drawer or indemnify it. The Privy Council agreed, stating that where a third party guaranteed the payment of a bill for the benefit of a holder, he was assumed unless the contrary appeared,

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[52] See also *Whiting* v. *Burke* (1871) L.R. 6 Ch. App. 342, affirming (1870) L.R. 10 Eq. 539. In *Harris* v. *Warner*, 13 Wendell 400 (N.Y. 1835), one had signed his name to a note as surety for the other maker. Subsequently, a third person signed, expressly as surety for the first two makers. It was held that the third signatory was a surety for the original surety. This was presumed to be the case in the absence of evidence that the third party merely wished to place himself in the same position as the prior surety. See in general, Campbell, "Non-Consensual Subsuretyship," (1935) 83 U. Pa. L. Rev. 326, 442, at 330-2.

[53] *Reynolds* v. *Wheeler* (1861) 10 C.B. (n.s.) 561; *Macdonald* v. *Whitfield* (1883) 8 App. Cas. 733; *Godsell* v. *Lloyd* (1911) 27 T.L.R. 383. Parol evidence is admissible to show the order of liability intended by the parties: *Craythorne* v. *Swinburne* (1807) 14 Ves. 160; *Whiting* v. *Burke* (1871) L.R. 6 Ch. App. 342, affirming (1870) L.R. 10 Eq. 539; *Harris* v. *Warner*, 13 Wendell 400 (N.Y. 1835).

[54] *Johnstone* v. *Inglis' Trustee* (1843) 5 Bell (S.C.) 1396.

[55] Similar decisions were reached in *D. & J. Fowler (Australia) Ltd.* v. *Bank of New South Wales* [1982] 2 N.S.W.L.R. 879 and *Maxal Nominees Pty. Ltd.* v. *Dalgety Ltd.* [1985] 1 Qd. R. 51.

[56] [1986] 1 A.C. 562.

[57] In fact, to a bank which became the holder by discounting the bills.

[58] [1984] V.R. 445, 456.

merely to have guaranteed the liability of one party to it, and not to have placed herself on the same level of liability as the drawer. The decision seems wrong: Z. had assumed liability as a surety for the acceptor, the party primarily liable on the bills. It seems a reasonable inference that she had interposed her liability between that of the acceptor (primarily liable) and that of the drawer (secondarily liable, in the event of the acceptor's default). Earlier Australian cases tended to this conclusion.[59]

In *Craythorne* v. *Swinburne*,[60] it was held that a surety in a bond with the principal was not entitled to contribution from a surety who was the sole obligor in a bond conditioned to be void on payment by either of the parties to the earlier bond.[61] In *Parsons* v. *Briddock*,[62] a bail (judicial surety) was held not to be entitled to contribution from sureties in an earlier bond, as it was held that the bail undertook his obligation for the benefit of the earlier sureties as well as the principal.[63] Where the defendant agreed to become surety on condition that another party joined as co-surety (although this did not appear from the guarantee), and the latter did not so join, but the plaintiff became a surety, and eventually paid the creditor, it was held that the plaintiff was not entitled to contribution from the defendant.[64] It has been suggested that, where the principal debtor was not a party to the contribution action, the claimant must prove the inability of the principal to pay.[65] It has also been suggested that where there are several co-debtors liable in the same degree, each is principal for his part and a surety for the parts of the others. Thus, if he pays the whole, his action against the others is not for contribution, but for indemnification by each of them for the part which was properly theirs.[66] In the modern law, this distinction, even if sound, should lead to no different a result.[67]

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[59] *D. & J. Fowler (Australia) Ltd.* v. *Bank of New South Wales* [1982] 2 N.S.W.L.R. 879; *Maxal Nominees Pty. Ltd.* v. *Dalgety Ltd.* [1985] 1 Qd. R. 51.

[60] (1807) 14 Ves. 160.

[61] See also *In re Denton's Estate* [1904] 2 Ch. 178.

[62] (1708) 2 Vern. 608.

[63] Conversely, the original surety would be entitled to subrogation to the creditor's rights against the bail. See, *e.g.*, *Schnitzel's Appeal*, 49 Pa. 23, 29 (1865) (bail for stay of execution on a judgment recovered against the principal and original surety, was liable to the original surety, it being held that he had interposed himself between the principal and original surety at the principal's request).

[64] *Barry* v. *Moroney* (1873) I.R. 8 C.L. 554, reversing (1872) I.R. 7 C.L. 110 (held that the defendant was entitled to succeed even though he had merely pleaded that the plaintiff had not paid money for the defendant).

[65] *Lawson* v. *Wright* (1786) 1 Cox 275.

[66] *Chipman* v. *Morrill*, 20 Cal. 130, 135 (1862).

[67] In *Wetzler* v. *Cantor*, 202 B.R. 573 (D. Md. 1996), it was held that a surety who claimed contribution from his co-sureties was entitled to a joint judgment against them. This was because the paying surety had

7.3.b Extent of the Surety's Recovery

The surety can only recover a contribution towards amounts which were actually due when he paid.[68] The common law rule in respect of co-sureties or other co-debtors was that each was liable to contribute his *aliquot* portion of the total debt, but no more. Thus, if one or more of the sureties became insolvent, the others would not be liable to make up the difference.[69] Unlike the original common law rule, the equitable rule was that solvent co-sureties should be liable to contribute equally to the payment of the principal's debt.[70] If the sureties were liable to different amounts, then they should contribute rateably.[71] In case of insolvency of one or more surety the sureties should be equally or rateably liable to make up the difference.[72] Under the Mercantile Law Amendment Act 1856, this rule should have prevailed, and it is thought that this remains the law in view of the saving provision in the statute which repealed that Act.[73] Whatever may have been the position at law, in equity, paying sureties could claim the proper contribution from the estates of their deceased fellow surety, and this remains the law.[74]

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been subrogated to the rights of the creditor, who would undoubtedly have been entitled to a joint judgment.

[68] *Lang* v. *Le Boursicot* (1993) 5 B.P.R. [97406] at 11,788, Supreme Court of New South Wales, Equity Division, McLelland J., 1993 N.S.W. LEXIS 7724; BC 9301960, judgment delivered on the 26th March 1993, at 12-14, 19. However, it has been held that a surety may recover a contribution towards a payment made in settlement of a claim by the creditor, even before the creditor had made a written demand, as required by the guarantee, if the debt was ascertained and such a demand could have been anticipated if the payment had not been made: *Stimpson* v. *Smith* [1999] 2 W.L.R. 1292. If a surety pays prematurely, it might be thought that he would become entitled to contribution from his co-surety at the time when the debt or instalment falls due, if the principal is unable to pay (by analogy with *Drager* v. *Allison* [1959] S.C.R. 661). However, *Lang* v. *Le Boursicot* seems to point to the contrary. A surety can, of course, only recover a contribution towards payments which he was obliged to make in respect of the principal's debt (or interest thereon, or the creditor's or his own costs): *Lang* v. *Le Boursicot* (holding that the surety was not entitled to recover amounts which were attributable to the purchase of leased goods, in respect of which the surety had guaranteed to pay the rent payable).

[69] *Cowell* v. *Edwards* (1800) 2 B. & P. 268; *Batard* v. *Hawes* (1853) 2 E. & B. 287. See also *Mackreth* v. *Walmesley* (1884) 51 L.T. 19, 20 *per* Kay J.

[70] *Dering* v. *Earl of Winchelsea* (1787) 1 Cox 318, 322. The civil law also adopted this result: Story, *op. cit.*, § 494, and note 3; § 496. It would appear that the insolvent co-surety is not a necessary party to the suit for contribution: *Whiting* v. *Burke* (1870) L.R. 10 Eq. 539, 545 (*semble*).

[71] *Pendlebury* v. *Walker* (1841) 4 Younge & Coll. 424, 441 *per* Alderson B.; *Steel* v. *Dixon* (1881) 17 Ch. D. 825, 830; *In re MacDonaghs* (1876) I.R. 10 Eq. 269. See also *Morgan Equipment Company* v. *Rodgers*, Supreme Court of New South Wales, Commercial Division, Giles J., 1993 N.S.W. LEXIS 7758; BC 9301995, judgment delivered on the 17th March 1993, where it was held that the sureties had varied the respective proportions which they were to contribute by agreement among themselves.

[72] *Peter* v. *Rich* (1629-30) 1 Rep. Ch. 34; *Hole* v. *Harrison* (1675) 1 Ch. Ca. 246; Rep. *temp.* Finch 15, 203; *Dallas* v. *Walls* (1873) 29 L.T. 599; *In re MacDonaghs* (1876) I.R. 10 Eq. 269; *Wolmershausen* v. *Gullick* [1893] 2 Ch. 514, 529.

[73] Statute Law Revision Act 1983, section 1 and First Schedule, Part IV. See *post.*

[74] See "Contribution by Sureties," (1875) 9 I.L.T.S.J. 493; Story, *op. cit.*, § 496. See also *Primrose* v. *Bromley* (1738) 1 Atk. 89, 90 *per* Lord Hardwicke L.C.; *Ashby* v. *Ashby* (1827) 7 B. & C. 444, 449 *per* Bayley J.

Where the claimant surety was compelled to pay the creditor's costs, he will be entitled to a contribution towards these from his co-sureties, at least where he did not unnecessarily increase the amount of those costs by mounting an unmeritorious defence.[75] Where a party acted reasonably and in the interests of all parties in resisting the creditor's claim, he was entitled to a contribution towards his costs of the defence from his co-sureties.[76]

At one time, it was held that a surety was not entitled to interest on the contribution to which he was entitled from his co-surety in the absence of a contract to that effect.[77] However, it is now established that where a surety claims a contribution from his co-surety, he is entitled to interest on the amount of the contribution which the co-surety is to make.[78] If the paying surety pays principal and interest to the creditor, he cannot recover interest on that interest.[79]

7.3.c Obligation of the Surety to account for Securities given him by the Creditor

Where one surety has a security from the principal debtor, he cannot claim a contribution from his fellow sureties unless he accounts for the value of the security which he possesses. Thus, in *In re Arcedeckne; Atkins* v. *Arcedeckne*,[80] one surety was obliged to bring the proceeds of policies on the debtor's life into account when claiming a contribution from a co-surety. Similarly, in *Latouche* v. *Pallas*,[81] a surety was granted leave to enforce a crown security against his co-surety, on his undertaking to assign a security which he held from the debtor to a trustee for himself and his co-surety. In *Steel* v. *Dixon*,[82] sureties who had received security from the principal debtor were held obliged to share the proceeds of it proportionately with paying sureties who had not received security. In *Burridge* v. *Burridge*,[83] it was held that a security given to one of a number of co-sureties enured for the benefit of all to the full amount of the debt. It was said that if a surety who had been given a security recovered the amount which he had paid from the security, he would be liable to share this amount with the other

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[75] *Cf. Kemp* v. *Finden* (1844) 12 M. & W. 421.
[76] *Wolmershausen* v. *Gullick* [1893] 2 Ch. 514, 529; *Morgan Equipment Company* v. *Rodgers*, Supreme Court of New South Wales, Commercial Division, Giles J., 1993 N.S.W. LEXIS 7758; BC 9301995, judgment delivered on the 17th March 1993.
[77] *Onge* v. *Truelock* (1831) 2 Moll. 31, 42-5. The surety and co-surety in that case had been bound together in a bond. The paying surety had paid the principal and interest to the creditor in 1799. Since the view was taken that payment by one surety discharged the bond, the entitlement to claim interest under the bond fell as well.
[78] *Lawson* v. *Wright* (1786) 1 Cox 275; *Hitchman* v. *Stewart* (1855) 3 Drew. 271; *Morgan Equipment Company* v. *Rodgers*, Supreme Court of New South Wales, Commercial Division, Giles J., 1993 N.S.W. LEXIS 7728; BC 9301964, judgment delivered on the 25th March 1993 (holding that interest was available at the "commercial" court rate, rather than at the trustee rate).
[79] *Peter* v. *Rich* (1629-30) 1 Rep. Ch. 34.
[80] (1883) 24 Ch. D. 709.
[81] (1832) Hayes 450.
[82] (1881) 17 Ch. D. 825.
[83] (1890) 44 Ch. D. 168.

sureties. However, he would then become entitled to recover the amount so shared from the security, and would again be bound to share that amount with the other sureties. In the end, the security would be shared equally, or the debt paid in full.

7.3.d Whether Equitable Grounds exist for refusing Contribution

In *Brown* v. *Cork*,[84] it was held that in assessing the "just proportion" which was the limit on the contribution which a surety could claim under Section 5 of the Mercantile Law Amendment Act 1856, account should not be taken of other transactions between claimant and respondent co-surety.[85] However, it has also been held that, as the claim for contribution is based on equitable principles, it may be resisted on equitable grounds.[86] Examples which have been given include cases where the paying surety obtained a benefit from the guarantee in a manner not contemplated by the parties when the guarantee was given,[87] or where the defendant surety was deprived of such a benefit by reason of the wrongful act of the paying surety.[88] So, in *Lang* v. *Le Boursicot*,[89] one co-surety for the payment of rent for leased goods had had possession of the goods for a time before it paid the rent due. McLelland J. said that if it could be shown that that surety had thereby obtained a financial benefit, then that sum should be debited against the payments of rent made by the surety in respect of which it sought a contribution.

7.4 The Surety's right of Subrogation

If it is accepted that the surety's rights may derive from implied contract in some instances, there seems to be no reason why he should not be deemed by implication to have contracted for a transfer of the

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[84] [1985] B.C.L.C. 363.

[85] *Cf. Dale* v. *Powell* (1911) 105 L.T. 291, where a paying surety had applied to the court for the assignment of a judgment which the creditor held against him and his co-surety. The paying surety had been a partner of the contributory co-surety, and partnership proceedings were in train between the two. The question arose whether the paying surety should be granted an assignment of the judgment, so that he could enforce it immediately against the co-surety, or whether the matter of his entitlement to enforce the judgment should be postponed to the determination of the partnership action. The court adopted the latter view. In *Brown* v. *Cork*, the Court of Appeal, though it distinguished the earlier case, accepted that the extent of a paying surety's right to enforce an assigned judgment was something which the court (or a Master) was entitled to consider on an application by an assignee of a judgment for leave to execute it under section 131 of the Common Law Procedure Act 1852 (15 & 16 Vict., c. 76), as applied by O. 42, r. 23 of the then Rules of the Supreme Court, now O. 46, r.2. Oliver L.J. stated that the court's discretion had been restricted under the new rule.

[86] *Lang* v. *Le Boursicot* (1993) 5 B.P.R. [97406] at 11,788, Supreme Court of New South Wales, Equity Division, McLelland J., 1993 N.S.W. LEXIS 7724; BC 9301960, judgment delivered on the 26th March 1993, at 17 (note that there was an equivalent of section 5 in force in New South Wales: section 3 of the Law Reform (Miscellaneous Provisions) Act 1965); *Trotter* v. *Franklin* [1991] 2 N.Z.L.R. 92.

[87] *Lang* v. *Le Boursicot*, at 17; *Bater* v. *Kare* [1964] S.C.R. 206.

[88] *Lang* v. *Le Boursicot*, at 18.

[89] (1993) 5 B.P.R. [97406] at 11,788, Supreme Court of New South Wales, Equity Division, McLelland J., 1993 N.S.W. LEXIS 7724; BC 9301960, judgment delivered on the 26th March 1993, at 18.

securities on payment.[90] Even where there is no implied contract, the statute,[91] in so far as it is still applicable, may be thought to express a policy that sureties should have a level of protection equivalent to that which was held by the creditor whom they have paid.[92] Since the surety's right is notorious, knowledge of it may encourage the giving of guarantees and the expansion of credit.[93]

7.4.a The Rights to which the Surety could be subrogated prior to the Statute

Equity came to recognise that the surety was entitled upon payment to the benefit of securities held by the creditor against the principal. So, in one case, the Irish Court of Exchequer said:

> "we lay it down as a broad position, that a surety paying off the debt of his principal is entitled, either against his principal or his cosurety, to the benefit of all securities which have not at law been discharged."[94]

In general, it seems that the surety would not be regarded as immediately entitled to enforce those securities by the mere fact of payment; an actual assignment would be required, though the surety was entitled to this as of right, and could enforce this right in a court of equity.[95] However, where a court of law would consider some of the securities (principally bonds and judgments) to have been extinguished or otherwise become unenforceable as a result of payment by a debtor (the surety), the chancery would refuse to order an assignment, as it was thought that the surety could not enforce them in a court of law.[96]

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[90] Though it is generally held that the right to subrogation does not derive from contract. See, *e.g.*, *Hodgson* v. *Shaw* (1834) 3 Mylne & K. 183, 191 *per* Lord Brougham L.C.: "It is hardly possible to put this right of substitution too high; and the right results more from equity than from contract or quasi contract; unless in so far that the known equity may be supposed to be imported into any transaction, and so to raise a contract by implication," quoted with approval in *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205, 207 (where it was stated that "the parties contract on the basis of that equity"); *Pearl* v. *Deacon* (1857) 24 Beav. 186, 190 *per* Romilly M.R., affirmed (1857) 1 De G. & J. 461; *Bowen* v. *Hoskins*, 45 Miss. 183; 7 Am. Rep. 728, 729-30 (1871) *per* Simrall J. In *Ryan* v. *Cambie* (1845) 9 Ir. Eq. R. 378, 393, Brady C.B. expressed the view that the principle that the surety was discharged from liability by an interference with a security which the creditor held over property of the principal debtor derived from contract.

[91] Section 5 of the Mercantile Law Amendment Act 1856 (19 & 20 Vict., c. 97).

[92] It has long been said that the surety was a "favoured debtor." See, *e.g.*, *Williamson* v. *Goold* (1823) 1 Bing. 171, 176 *per* Dallas C.J.; *In re Sherry; London and County Banking Co.* v. *Terry* (1884) 25 Ch. D. 692, 703 *per* Lord Selborne L.C. *Cf. Wheatley* v. *Bastow* (1855) 7 De G., M. & G. 261, 280 *per* Turner L.J. *Contra*: *In re O'Neills Minors* (1837) S. & Sc. 686. In *Batchellor* v. *Lawrence* (1861) 9 C.B. (n.s.) 543, Byles J. said (at 555): "In all rational systems of law, where a surety pays the debt, he is entitled to the benefit of all securities which the creditor held."

[93] Of course, the vast majority of contracts of guarantee limit the surety's rights in such a way that none of them is enforceable until the creditor has been paid in full. Thus, it may be rather unrealistic to discuss the supposed restitutionary rights of the surety without adverting to this fact.

[94] *Salkeld* v. *Abbott* (1832) Hayes 576, 584 (*per* Pennefather B.).

[95] See *post*.

[96] *Copis* v. *Middleton* (1823) Turn. & R. 224; *Salkeld* v. *Abbott* (1832) Hayes 576, 582. So, Dixon wrote (*op. cit.*, 47): "If, on payment of a debt, the property given as security returns by the mere fact of payment to the debtor, he may dispose of it by sale or otherwise, so as to give the purchaser not only an equitable

It does not appear that the surety had to demand the assignment at or before the time of payment. However, payment unaccompanied by a transfer to a third party would often have the effect of extinguishing the debt and security, and rendering a subsequent assignment ineffective. It was, however, generally held that there could be a valid transfer to a third party as trustee for the surety.[97]

Section 5 of the Mercantile Law Amendment Act 1856[98] altered the law, giving a statutory right of indemnity and subrogation to a surety or co-debtor who had paid more than his proper proportion of the debt. The effect of the provision was to remove the former limitations on the surety's right of subrogation. However, the 1856 Act was repealed in 1983, and there is now no equivalent provision in Irish law. The repealing Act[99] contained an elaborate if general saver of legal and equitable rights, procedures and jurisdictions arising out of the repealed statute. It is thus a difficult question whether this provision retained the effect of the repealed section. We will first of all consider the position prior to the 1856 Act.

(i) Bonds in which the Principal and Surety were bound

Originally, a surety in a bond with the principal was entitled to have it assigned to him on paying the creditor, so that he might enforce it against the principal.[100] However, as a result of a change in the law,[101] it came to be held that the effect of payment by the surety was to discharge the bond, and render it impossible for him to pursue the principal on it, even if it were assigned to him.[102] So, in *Hodgson* v.

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right, but a legal title such as must, on principles of justice, prevail over the claim of the surety, who by his own neglect has permitted the property to return under the control of the debtor. The surety can have no relief, by way of subrogation, by operation of law except in those cases, as of mortgages of land, where the security does not, on payment, return to the debtor"; *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205, 207: "The surety, if the security be not discharged, is entitled to the benefit of the securities of the principal." In *Lake* v. *Brutton* (1856) 8 De G., M. & G. 440, a subsequent assignee of an insurance policy mortgaged by the principal debtor was held to have taken subject to the surety's right, although in that case, he had been on notice of the surety's obligation (and consequent rights). *Cf. Edgerley* v. *Emerson*, 23 N.H. 555; 55 Am. Dec. 207 (1851) (discussed in Dixon, *op. cit.*, at 72-3), where the court observed that it was always of the nature of a security to be a mere incident of the debt, and thus to be discharged by payment of the debt. See also *Eddy* v. *Traver*, 6 Paige Ch. 521, 525 (N.Y. 1837) *per* Walworth C. However, the court stated that an exception should be acknowledged to this principle in cases of payment by a surety. Again, in *Bowen* v. *Hoskins*, 45 Miss. 183; 7 Am. Rep. 728, 729-30 (1871), Simrall J. expressed disapproval of *Copis* v. *Middleton*, and said that "[t]he American courts give a wider range to the principle, and work out a more perfect justice, by considering the judgment as equitably assigned to the surety, and as having all its incidental advantages, for the purposes of contribution, as against the principal debtor and his subsequent lien creditors." Also, *Leiter* v. *Carpenter*, 22 A. 2d 393, 395 (Del. Ch. 1941).

[97] *Hayes* v. *Ward*, 4 Johns. Ch. 123 (N.Y. 1819); *Copis* v. *Middleton* (1823) Turn. & R. 224.

[98] 19 & 20 Vict., c. 97.

[99] Statute Law Revision Act 1983, section 1 and Schedule I, Part IV.

[100] *Morgan* v. *Seymour* (1637-38) 1 Rep. Ch. 120.

[101] Under the provisions of (1705) 4 Anne, c. 16 (England), section 12 and (1707) 6 Anne, c. 10 (Ireland), section 12 (both Acts entitled "An Act for the Amendment of the Law, and the better Advancement of Justice").

[102] *Gammon* v. *Stone* (1749) 1 Ves. Sen. 339; *Woffington* v. *Sparks* (1754) 2 Ves. Sen. 569, 570; *Copis* v. *Middleton* (1823) Turn. & R. 224, 231 *per* Lord Eldon L.C.; *Hodgson* v. *Shaw* (1834) 3 Mylne & K. 183,

Shaw,[103] a surety in a later bond, on payment to the creditor, was held entitled to an assignment of an earlier bond by the principal debtor, in which he had not been a party. Even where the surety had been a party to the bond with the principal, it could be effectively transferred to a third party as trustee for the surety upon payment by the latter. In such a case, the court would have regarded the third party as a purchaser of the bond, which would therefore remain enforceable.[104] The surety could avail of it in this way.

(ii) Judgments held by the Creditor against the Principal Debtor

While courts of equity accepted that the surety was on the face of it entitled to the benefit of judgments held by the creditor against the principal or a co-surety, in some circumstances they felt constrained to hold that the surety's payment had extinguished the judgment.

Where the creditor had recovered judgment against the principal, and had established it as a charge on the estate of the principal in a foreclosure suit, sureties who paid the creditor were entitled to an assignment of the benefit of the judgment, the charge, and the proceedings.[105] In *Kent* v. *Executor of Canter*,[106] the creditor had obtained judgment against one of two joint and several obligors in a bond. The other co-obligor paid the debt, and took an assignment of the judgment. It was held that he was entitled to enforce it against the judgment debtor.

Where a creditor recovered separate judgments against principal and surety or several sureties, who had been bound in the same bond, Irish courts generally held that the surety who paid was entitled to an assignment of the separate judgment against the principal or other surety.[107] English courts generally

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195; *Jones* v. *Davids* (1828) 4 Russ. 277; *Salkeld* v. *Abbott* (1832) Hayes 576, 582. *Cf. Cheesebrough* v. *Millard*, 1 Johns. Ch. 409 (N.Y. 1815); *Robinson* v. *Wilson* (1818) 2 Madd. 434, 437; *Onge* v. *Truelock* (1831) 2 Moll. 31, 42; *Salkeld* v. *Abbott* (1832) Hayes 576, 584 *per* Pennefather B.; *Caulfield* v. *Maguire* (1845) 8 Ir. Eq. R. 164, 177 *per* Sir Edward Sugden L.C.; *Dawson* v. *Lawes* (1854) 23 L.J. Ch. 434, 438 *per* Wood V.-C. It appeared, however, that where the personal representatives of the surety paid the debt, the principal debtor could not have pleaded this as a defence, as payment by someone who was not an obligor was no defence to a suit on the bond: *Bishop* v. *Church* (1750-1) 2 Ves. Sen. 100; 371, 372.

[103] (1834) 3 Mylne & K. 183.

[104] See, *e.g.*, *Butcher* v. *Churchill* (1808) 14 Ves. 567.

[105] *Scott* v. *Lowry* (1824) Hayes 95, note. The case was followed in *Peoples* v. *Stewart* (1830) Hayes 90, which seems to have been a case of separate judgments against principal and surety, though the report does not specify this.

[106] (1791) Wall. Lyne 364.

[107] In *Hill* v. *Kelly* (1794) Ridg., Lapp & Sch. 265; *Purdon* v. *Purdon* (1827) 1 Huds. & Br. 229, 248 *per* Vandeleur J.; *Mara* v. *Ryan* (1838) 2 Jones 715; *Peoples* v. *Stewart* (1830) Hayes 90. *Contra*: *Wheeler* v. *Doyne* (1830) 3 Law Rec. (o.s.) 264. *Cf. Clason* v. *Morris*, 10 Johns. 524, 539 (*per* Spencer J.); 546-7 (*per* Thompson J.) (N.Y. 1812) (case of separate judgments against surety and principal; on payment to creditor, surety considered to be a purchaser of the judgment against the principal); *Edgerley* v. *Emerson*, 23 N.H. 555; 55 Am. Dec. 207 (1851); *Cottrell's Appeal*, 23 Pa. 294 (1854).

held that the surety was not entitled to such an assignment.[108] The safest course for the surety in such a case, was to cause the creditor to assign his judgment against the principal to a trustee for the surety, the trustee being supposed to have purchased the judgment.[109]

Where a single judgment had been obtained against both a principal debtor *and* surety in the same joint or joint and several bond, it was a more difficult question whether the judgment would survive payment by the surety. In an early case, *Greerside* v. *Benson*,[110] Lord Hardwicke L.C. held that sureties in an administration bond, against whom the obligee had obtained a decree (together with the principal) were, upon payment to the obligee, entitled to enforce the decree in his name against the principal. Equally, if one surety paid more than his fair share, he was entitled to enforce the decree against the others for a contribution. In *Sir Daniel O'Carroll's Case*,[111] the surety had joined with the principal in a note payable by instalments. The principal became insolvent and was discharged after the first payment became due. The creditor sued the principal and the administratrix of the surety. Lord Hardwicke L.C. held that the creditor should have a decree against the surety, who should have a decree over against the principal, notwithstanding the discharge of the principal.[112] In the North Carolina case, *Briley* v. *Sugg*,[113] it was held that the judgment against the principal did not survive payment by the surety.[114] A series of other American cases were more liberal.[115]

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[108] *Dowbiggin* v. *Bourne* (1830) Younge 111; (1837) 2 Younge & C. 462; *Armitage* v. *Baldwin* (1842) 5 Beav. 278, earlier proceedings (1836) 5 A. & E. 76, *sub nom.*, *Armitage* v. *Baldwin*.

[109] See, *e.g.*, *Dillon* v. *Farrell* (1827) Batty 669.

[110] (1745) 3 Atkyns 248.

[111] (1745) Ambler 61.

[112] The reasoning, as reported, is hard to follow.

[113] 1 Devereux & Battle's Eq. 366; 30 Am. Dec. 172 (N.C. 1836).

[114] The court followed its earlier decision in *Sherwood ex rel. State Bank* v. *Collier*, 3 Devereux Law 380; 24 Am. Dec. 263, 265 (N.C. 1832). See Dixon, *op. cit.*, 70. Similarly, *Hammatt* v. *Wyman*, 9 Mass. 138 (1812); *Brackett* v. *Winslow*, 17 Mass. 153 (1821) (judgment against two co-debtors was paid by one, but was, by agreement with the creditor, returned marked "unsatisfied"; still, the payment by one was held to have discharged both judgment debtors).

[115] *Creager* v. *Brengle*, 5 Harr. & J. 234; 9 Am. Dec. 516 (Md. 1821); *Lidderdale's Executors* v. *Executor of Robinson*, 12 Wheat. (25 U.S.) 594; 6 L. Ed. 740 (1827); *Fleming* v. *Beaver*, 2 Rawle 128, 132; 19 Am. Dec. 629, 631 (Pa. 1828) (drawing a distinction between the case of a voluntary intervener and that of one who is bound for a debt and pays under compulsion); *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588, 602 (1837) *per* Tucker P. (*dictum*: "though the judgment is in fact extinguished by the payment, yet it is kept alive in contemplation of equity, for the benefit of the surety"); *Croft* v. *Moore*, 9 Watts 451, 455 (Pa. 1840); *Williams* v. *Tipton*, 5 Humph. 66; 42 Am. Dec. 420, 421 (Tenn. 1844); *Lathrop and Dale's Appeal*, 1 Pa. 512, 517 (1845) (although the decision involved a somewhat different point); *Gossin* v. *Brown*, 11 Pa. 527, 532 (1849) (*dictum*). For far more recent authority, see *Nelson* v. *Webster*, 72 Neb. 332; 100 N.W. 411, 414; 68 L.R.A. 513; 117 Am. St. Rep. 799 (1904) (held, that a surety, bound jointly in a judgment with the principal debtors, having obtained an assignment, was entitled to enforce it against the two principals; payment had not been a discharge, and there was no requirement for the surety to bring an action to declare his right of subrogation); *Exchange Elevator Co.* v. *Marshall*, 147 Neb. 48; 22 N.W. 2d 403 (1946) (see J.W. Wade, *Cases and Materials on Restitution* (1976), 159-163); Stearns, *op. cit.*, § 11.4.

(iii) Recognisances by the Principal Debtor

A recognisance is an acknowledgement of indebtedness enrolled in court, and could be enforced in like manner as a judgment. Originally, these were nominally securities granted to the crown, in the sense that the crown became creditor, as trustee for the parties actually interested.[116] Where a principal debtor had entered into a recognisance, and the surety paid the amount of it, he was generally allowed to enforce the recognisance in the same manner as the creditor. Where sureties were bound by separate recognisances, he who paid was entitled to put the recognisance of the other in suit,[117] though he required the leave of the court for this.[118] It was regarded as a more difficult question whether a surety bound in the same recognisance with the principal or a co-surety could be entitled to put it in suit against that other,[119] though the Irish cases came to the conclusion that he could, provided that the recognisance would be treated by a court of law as still extant.[120]

(iv) The Surety's Right to the benefit of a Mortgage granted by the Principal Debtor to the Creditor

It was long accepted that if a principal gave a creditor a mortgage or other security over real property to secure his debt, the surety, upon payment, would be entitled to the benefit of the mortgage, and might therefore demand an assignment of it from the creditor. Payment by the surety would not extinguish the mortgage, even where the surety had joined in it (either as co-mortgagor or as guarantor), because the legal estate or security interest would remain in the creditor until such time as he executed a re-conveyance to the principal debtor.[121] The surety appears to have enjoyed a beneficial interest in the property in the creditor's hands pending an assignment to him. In *Plumbe* v. *Sandys*,[122] a surety in a bond to the creditor was held entitled to an assignment of a mortgage granted by the principal to the creditor.[123]

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[116] *R.* v. *Bayly* (1841) 1 Dr. & War. 213; 4 Ir. Eq. R. 142. It was later held, however, that in cases of crown bonds (*i.e.*, securities granted to the crown in its own right), the crown was the creditor, and was under no strict legal obligation to pay over sums which it recovered on the bond to persons who had suffered a loss as a result of the obligor's defaults: *In re Russell's Estate; Dundalk Gas Co.* v. *Russell* [1933] I.R. 578, 583. Johnston J. in that case recognised a distinction between a recognisance and a crown bond for the performance of the duties of a public official. *Cf. R.* v. *Clark* (1726) Bunb. 221; Comyns 388 *per* Pengelly C.B., to the effect that the king could not be a trustee for a private person.

[117] *Dalton* v. *Robins* (1836) 4 Law Rec. (n.s.) 240. See also *In re Skerrets, Minors* (1834) 3 Law Rec. (n.s.) 78, where the surety for a *tenant* was allowed to put in suit the recognisance of a surety for the *receiver*.

[118] *R.* v. *Daly* (1839) 1 I.L.R. 381; *R.* v. *Bayly* (1841) 1 Dr. & War. 213; 4 Ir. Eq. R. 142; *R.* v. *O'Donnell* (1844) 1 J. & La T. 271; 6 Ir. Eq. R. 639; *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205, 207.

[119] There was an inconclusive judgment in *Woods* v. *Creaghe* (1828) 2 Hogan 50.

[120] *Anon.* (1839) Wall. Lyne 367n. (Lord Plunket L.C.); *Salkeld* v. *Abbott* (1832) Hayes 576; *Latouche* v. *Pallas* (1832) Hayes 450; *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205. See also *In re Nugent's Assignees' Estate* [1907] 1 I.R. 198.

[121] *Copis* v. *Middleton* (1823) Turn. & R. 224, 231 *per* Lord Eldon L.C.; *Salkeld* v. *Abbott* (1832) Hayes 576, 584 *per* Pennefather B.; *Gossin* v. *Brown*, 11 Pa. 527, 532 (1849).

[122] (1818) 2 Coop. *temp.* Cott. 523.

[123] See also *Gaynor* v. *Royner* (1777) 2 Maddock 437n.

As regarded pledges of personal property, there was a question whether the effect of payment would not be to cause the property to revert to the debtor, preventing the surety from availing of it.[124]

(v) The Surety's right of Subrogation to the Prerogative Process of the Crown

Where a debtor to the crown gave a bond to the crown, it was regarded, when recorded in court as being in the nature of a recognisance, or acknowledgement of indebtedness to the crown, and could be enforced as if it were a judgment. *Magna Carta*[125] had recognised that a surety to the crown was entitled to obtain recompense out of the lands of the debtor, after payment. However, this provision was easily avoided by the universal practice of binding the surety jointly and severally with the principal in a bond to the crown.[126] Nonetheless, the Courts of Exchequer were willing to allow the surety who had paid to enforce the crown process against the principal debtor for indemnification, or against co-sureties for contribution. Indeed, there is a record of proceedings in the Irish Exchequer at the beginning of the fourteenth century where this occurred.[127] In a series of eighteenth century cases, "[a] surety paying the Crown's debt was ordered to stand in the place of the Crown, and to have the aid of the Court to recover the whole against the principal in the bond or a moiety against the other surety."[128]

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[124] Dixon, *op. cit.*, 50 (also stating that, in either case, if the property had re-vested in the principal, it would be too late for an assignment to the surety).

[125] C. 9.

[126] *Anon.* (1557-1602) Cary 12; Loyd, "The Surety," (1917) 66 U. Pa. L. Rev. 40, 50; C.P. Cooper, *Reports*, Appendix, at 674 n. 1; Britton, c. 28. In *R.* v. *Fay* (1878) 4 L.R. Ir. 606, following *Attorney General* v. *Resby* (1664) Hard. 377 and *Attorney General* v. *Atkinson* (1827) 1 Y. & J. 207, Palles C.B. observed that chapter eight of Magna Carta did not apply to sureties in a bond or recognisance who were bound equally with the principal, but only to those who were bound expressly as pledges.

[127] *Le Blond* v. *de Rupe* (1295) 1 Calendar of Justiciary Rolls of Ireland 16. In the much later case of *R.* v. *Fay* (1878) 4 L.R. Ir. 606, (on which, see below), counsel for the defendant (Webb, Q.C. and Howley) offered the following propositions (at 621):

> "If the right of subrogation exists at all in the case of the Crown, it is *ex debito justitiae*, and rests on a higher basis than even as between subject and subject on the Statute of Equity [(1541-2) 33 Hen. VIII, c. 39, s. 79 ("An Act concerning the Erection of the Court of Surveyors"]. There are three steps in the extension of the right of Crown process to the surety: (*a*). Magna Charta, 9 Hen. 3, c. 8, gave the right to manucaptors or pledges only. (*b*). The Exchequer gave it to the debtor paravail [citations omitted]. (*c*). It was then extended to the surety proper ... and it was *ex debito justitiae* [citations omitted]."

[128] *R.* v. *Doughty* (1702) Wightw. 2n. The later cases included *R.* v. *Clark* (1726) Comyns 388; Bunbury 221 (*sub nom.* "*R.* v. *Clarke*"), where it was said that "if the principal debtor to the king fail, and his sureties pay ... the sureties shall have the prerogative process against the principal." However, the surety was held to have waived his right to use the crown process by taking a bond from the surety and principal debtor. In *R.* v. *Babb* (or "Bubb") (1706) Wightw. 3n., the widow of a surety for one of several crown debtors had compelled the other co-debtors to be extended, and now prayed an order that she might be at liberty to pay the remainder owing, and then have the aid of crown process against the debtors. This was so ordered. She was also entitled to be reimbursed her expenses in the same way.

7.5 Section 5 of the Mercantile Law Amendment Act 1856

In order to improve the position of the surety, and to provide that he was entitled to enforce all securities held by the creditor against the principal, section 5 of the Mercantile Law Amendment Act 1856[129] was enacted. The motivation seems to have been to assimilate the law of England and Ireland with that of Scotland, which recognised the surety's right to a cession of the creditor's rights, without any limitation on the ground that certain of them were extinguished by payment.[130] Section 5 was as follows:

> "Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, shall pay such debt or perform such duty, shall be entitled to have assigned to him, or to a trustee for him, every judgment, specialty, or other security which shall be held by the creditor in respect of such debt or duty, whether such judgment, specialty or other security shall or shall not be deemed at law to have been satisfied by the payment of the debt or performance of the duty, and such person shall be entitled to stand in the place of the creditor, and to use all the remedies, and if need be, and upon a proper indemnity, to use the name of the creditor, in any action or other proceeding, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as the case may be, indemnification for the advances made and loss sustained by the person who shall have so paid such debt or performed such duty, and such payment or performance so made by such surety shall not be pleadable in bar of any such action or other proceeding by him: Provided always, that no co-surety, co-contractor, or co-debtor shall be entitled to recover from any other co-surety, co-contractor, or co-debtor, by the means aforesaid, more than the just proportion to which, as between those parties themselves, such last-mentioned person shall be justly liable."

It will be seen that the section affords the same rights to co-debtors as to sureties.

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[129] 19 & 20 Vict., c. 97.

[130] See C. Mitchell, *The Law of Subrogation* (1994), 57-8. In *Embling* v. *McEwan* (1872) 3 V.R. (L.) 52, 53, Stawell C.J. explained the rationale of the Act as follows:

> "The '*Mercantile Law Amendment Act* 1856' was passed to remedy, amongst others, an inconvenience to traders arising from a difference between the law of England and that of Scotland. In England, a surety paying the debt was not entitled at law to the benefit of securities which the creditors held, whereas in Scotland he was. His remedy in England was in a court of Equity, and relief was given to him there on principles borrowed from the civil law, and administered with regard to the respective rights and immunities of all subject to contribution."

7.6 The Effect of Section 5

It will be noted that the section expressly provided that a surety or co-debtor was entitled to an assignment of any judgment, specialty or security held by the creditor in respect of the debt, whether or not it would be deemed to have been discharged by payment at law. This reversed earlier decisions which had held that the surety or co-debtor could not demand an assignment of those securities which would have been regarded at law as discharged by payment.[131] The section further provided that payment or performance made by the surety should not be pleadable in bar of an action brought by the surety.

7.6.a The Manner of Enforcement of the Surety's Rights

The section stated that the surety "shall be entitled to have assigned to him" every security held by the creditor for the debt. Thus, it appeared that the surety did not automatically "step into the shoes" of the creditor.[132] If the creditor failed to execute an assignment to the surety, the latter might have brought proceedings to require it.

In *Everingham* v. *Waddell*,[133] sureties had paid the creditor, who held a bill of exchange drawn on the principal debtor and a contract of sale of chattels as security from the principal. At the time of payment, the sureties had not asked for an assignment of the securities. They later requested an assignment, but the creditor declined, though he offered to indorse the bill of exchange to them, on the basis that they would not have recourse against him. The sureties declined the offer and brought an action, claiming to be entitled to an assignment by deed. They argued that, if they obtained the assignment sought, they could sue the principal in the name of the creditor, whereas if the bill was merely endorsed, they would have to sue in their own names. Stawell C.J. seemed to think that this point was of some weight. He stated that:

> "The section seems to imply it shall be by deed. The words of the Act negative an endorsement. The surety is not to sue in his own name, but in the name of the person who held the security; and is to give him an indemnity."[134]

At a later point, he stated:

See also *Batchellor* v. *Lawrence* (1861) 9 C.B. (n.s.) 543, 555-6 *per* Byles J.

[131] See *ante*.

[132] *Cf.* Mitchell, *op. cit.*, 60.

[133] (1881) 7 V.L.R. 180 (on the construction of an identical Victorian statutory provision).

[134] (1881) 7 V.L.R. 180, 183.

> "I think the word 'assigned' implies a deed, more especially taking into consideration the other part of the section, giving the assignee a right to all the remedies, and to use the name of the creditor; and I do not see any reason why a bill of exchange should be placed in a different position from other securities."[135]

Further, the surety was entitled to demand an assignment by deed if he so wished, and was prepared to pay for it at his own expense.[136]

If a creditor refuses to assign securities when he has been paid by a surety or co-debtor, the latter may bring an action claiming damages for the failure to make the assignment.[137] In *Embling* v. *McEwan*,[138] a co-debtor had paid the principal, interest and costs of a judgment which had been recovered against him and his co-debtors. Despite request made by the paying co-debtor, the creditor refused to assign the judgment to him. The paying co-debtor therefore brought an action against the creditor, claiming damages for refusing to assign the judgment. He did not plead any special damage. He claimed to be entitled to the amount of the judgment less his own proper proportion and less the proportion of a co-debtor who had become insolvent before the judgment had been obtained. The defendant claimed that he was merely entitled to nominal damages. Stawell C.J. held that the defendant was *prima facie* liable for the full amount of the judgment less the plaintiff's proportion, on the basis that every person was presumed to be solvent until the contrary was shown. The onus of proof of the insolvency of the other co-debtors lay on the defendant. Therefore, it was not necessary for the plaintiff to plead special damage. He also held that it was not necessary for the plaintiff to have offered an indemnity to the defendant at the time of the request for the assignment. The subsequent insolvencies of any of the co-debtors were irrelevant in deciding the quantum of damages in this case. Furthermore, if the plaintiff subsequently sought contribution from the co-debtors, he was obliged to give them credit for the amount which he received from the defendant.

Section 5 clearly stated that the surety was entitled "if need be, and upon a proper indemnity," to bring proceedings in the name of the creditor.[139] There appeared, however, to be few circumstances where

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[135] (1881) 7 V.L.R. 180, 185.

[136] Higinbotham J. agreed, stating ((1881) 7 V.L.R. 180, 186):

> "I apprehend that the surety is entitled to have the security assigned to him by any effectual means he may think fit to employ, provided the instrument of assignment purports, on the part of the creditor, to do no more than to assign the securities, and provided it does not contain any untrue recitals as to the circumstances under which the surety's right has grown up."

[137] *Batchellor* v. *Lawrence* (1861) 9 C.B. (n.s.) 543.

[138] (1872) 3 V.R. (L.) 52.

[139] *Swire* v. *Redman* (1876) 1 Q.B.D. 536, 541 *per* Cockburn C.J.:

this would be more advantageous to the surety than proceeding in his own name. One case might be where a creditor has already recovered judgment against the principal. It is noted that insurers sometimes encounter difficulties where they are required to bring proceedings in the name of the insured.[140]

The section expressly provided that payment by a surety should not be pleadable in bar of an action brought by him against the principal debtor or a co-surety even if brought in the name of the creditor. This is, of course, even though the payment by the surety to the creditor discharges the debt owed by the principal debtor to the creditor. The effect of section 5 was therefore to "revive" the debt and security. Therefore, if proceedings are brought in the name of the creditor against the principal debtor, it seems that the principal debtor could plead payment by the surety unless the surety revealed that he was suing in the name of the creditor.

7.7 Repeal of the Mercantile Law Amendment Act 1856 and saver

The 1856 Act was repealed in its entirety by the Statute Law Revision Act 1983.[141] The repeal appears to have taken place in the belief that the Act was spent or superfluous. It is not, however, clear that the law in Ireland has reverted to its state as of 1856, prior to the enactment of the Act.[142] Section 2(1) of the repealing Act contains a "saver." This provides that

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> "...the surety has a right at any time to apply to the creditor and pay him off, and then (on giving a proper indemnity for costs) to sue the principal in the creditor's name. We are not aware of any instance in which a surety ever in practice exercised this right; certainly the cases in which a surety uses it must be very rare. Still the surety has this right."

Also, *In re Kirkwood's Estate* (1878) 1 L.R. Ir. 108 and *Carter* v. *White* (1884) 25 Ch. D. 666, 670 *per* Cotton L.J. For an instance prior to the Act, see *Lindsay* v. *Lord Downes* (1840) 2 Ir. Eq. R. 307, 312 *per* Lord Plunket L.C.

[140] See *post.*

[141] Section 1 and First Schedule, Part IV. Section 5 of the Act is still in force in Northern Ireland and England and Wales. The Act never applied to the Isle of Man: *In re Milnes Waverley Ltd. (in liq.)* [1978-80] Manx L.R. 256.

[142] Section 21(1) of the Interpretation Act 1937 provides in part as follows: "Where an Act of the Oireachtas repeals the whole or a portion of a previous statute, then unless the contrary intention appears, such repeal shall not - (a) revive anything not in force or not existing immediately before such repeal takes effect..." These words appear to be most apt to describe a statute or statutory instrument, and less so to describe a common law or equitable rule. A. Lyall, *Land Law in Ireland* (1994), x, appears to make an over-broad statement when he says that the Act "makes it clear that where a statute repeals the whole or part of a previous statute, the repeal does not have the effect of reviving the earlier law which applied before the affected statute." However, one may doubt whether the section was intended to apply to non-statutory law (Dr. Lyall was writing in the context of statute law). As a matter of construction, a rule of common law or equity would probably not be described as being "in force." However, it could certainly be said to "exist." Presumably it might well be the legislative intent to cause the law to revert to a pre-statutory condition (although in the present case, one would be hard put to suggest a rational motive for it). The relevance of the Interpretation Act is therefore unclear, but on balance, it is felt that it does not affect the interpretation to be put on the repeal.

"This Act shall not affect any existing principle or rule of law or equity, or any established jurisdiction, form or course of pleading, practice or procedure, notwithstanding that it may have been in any manner derived from, affirmed or recognised by any enactment hereby repealed."

The principal changes effected by section 5 of the 1856 Act appear to have been that (a) payment by a surety or co-debtor would not be deemed to extinguish certain securities, the surety or co-debtor being entitled to an assignment of them and (b) the equitable rule of contribution (*i.e.*, that solvent sureties should be liable to make up the portion of the debt properly payable by the insolvent surety) in all cases prevailed over the rule at law. The section also permitted the surety or co-debtor to sue in the name of the creditor "if need be," and it is not clear whether or not the surety or co-debtor was always entitled to this, even when a security remained extant, prior to the Act.[143] It is also arguable that the section permitted persons who had become sureties or co-debtors without the assent of the principal or other debtor to be subrogated to the creditor's rights where they might not have been so entitled at common law.[144] If section 5 is considered still to be in force, in "ghost" form, then it may be that a waiver of a right under that section must be more unequivocal than a waiver of an equitable or common law right to subrogation or indemnification.

An identical saving clause was the subject of judicial consideration in a case which considered the effect of the repeal of the Act for Joint Tenants 1542,[145] on the jurisdiction to order partition of property owned by joint tenants or tenants in common.[146] In *F.F.* v. *C.F.*,[147] Barr J. held that a joint tenant's right to partition fell within the meaning and intent of the phrase "any existing principle or rule of law or equity" in an identical saving clause,[148] and that the right was one which was derived from the 1542 Act. Therefore, the court's jurisdiction to order partition, or sale in lieu thereof (under the Partition Act 1868) survived. The 1542 Act was repealed in Northern Ireland in 1950.[149] In two cases, it has been held that the equitable jurisdiction to order partition has nonetheless survived. In the first, *Glass* v. *McManus*,[150] Girvan J. held that after the enactment of the 1542 Act, which gave a legal writ for partition to joint tenants and tenants in common, the right of co-owners to bring suits for partition had become well established in the law of real property. He also held that equity had evolved an equitable right to partition

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[143] *Cf. Lindsay* v. *Lord Downes* (1840) 2 Ir. Eq. R. 307, 312 *per* Lord Plunket L.C.
[144] This view was expressed by A. Burrows, *The Law of Restitution* (1993), 83, 215. *Cf. Owen* v. *Tate* [1976] 1 Q.B. 402, section 3.8.a, *ante*.
[145] 33 Hen. VIII, c. 10 (Ir.).
[146] See, in general, Conway, "The Repeal of An Act for Jointenants 1542 and the Jurisdiction to order Partition or Sale under the Partition Acts 1868 and 1876," (1997) 19 D.U.L.J. (n.s.) 1.
[147] [1987] I.L.R.M. 1.
[148] Section 2(2) of the Statute Law Revision (Pre-Union Irish Statutes) Act 1962.
[149] Statute Law Revision Act 1950 (U.K.) (14 Geo. VI, c. 6), section 1(1), and Second Schedule.
[150] Unreported, 7th June 1997, Girvan J.

which survived when the common law writ of partition was abolished in most cases in 1834.[151] In the second decision, *Fraser Homes Ltd.* v. *Fraser Houses (N.I.) Ltd.*,[152] Campbell J. again held that although the equitable jurisdiction to order partition may have derived from the 1542 Act, it was nonetheless independent of the Act. The repealing statute contained a saver which was similar to that contained in section 2(1) of the 1983 Act, though more elaborate. Campbell J. stated that since the equitable jurisdiction to order partition derived from the 1542 Act, unlike the former common law jurisdiction, which was created by it, the equitable jurisdiction survived the repeal of the statute.

Thus, Barr J. found that the co-owner's right to partition was an existing principle or rule of equity, which survived the repeal of the Act which originally gave the common law right to partition, while the Northern Irish judges found that the court's equitable jurisdiction to order partition derived from the Act, but survived the repeal.[153] Considering the effect of the saver on the repeal of section 5 of the 1856 Act, it seems that the words "principle or rule of law or equity" are apt to describe the surety or co-debtor's right to an assignment of securities, or to stand in the place of the creditor, even though those securities might otherwise have been regarded as discharged. It would therefore appear that the repeal has not altered the law in this regard, and a surety in a joint or joint and several bond or judgment, on paying the creditor, is still entitled to have it assigned to him for enforcement against the principal debtor.

A similar argument seems to apply with equal force to the predominance of the equitable rule of contribution. It is also arguable that under section 28(11) of the Supreme Court of Judicature (Ireland) Act 1877,[154] the equitable rule prevails.[155] Similarly, the surety or co-debtor's right in some cases to use the creditor's name, has probably survived as an "established ... form or course of pleading, practice or procedure," though it seems to be a right which has seldom been exercised.

The case of the "voluntary surety" remains unresolved. It has never been conclusively established that such a surety had a right to subrogation under section 5, though a literal reading of the section afforded no reason why he should not.[156] It is therefore hard to see how there could be shown to be an "existing principle or rule of law or equity" entitling him to subrogation which might have survived the repeal of the section.

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[151] Real Property Limitation Act 1833 (3 & 4 Will. IV, c. 27), section 36 (save as to dower). The statute came into effect on the 31st December 1834.
[152] *The Irish Times* Law Report, 3rd August 1998 (judgment of the 5th June 1998).
[153] See also *Leeds Industrial Co-operative Society Ltd.* v. *Slack* [1924] A.C. 851, 862 *per* Viscount Sumner: "It is a truism that a Statute Law Revision Repeal was never intended to alter the law, but merely to remove from the Statute Book enactments which were obsolete or unnecessary..."
[154] 40 & 41 Vict., c. 57.
[155] That subsection states that "[g]enerally, in all matters not herein-before particularly mentioned in which there is any conflict or variance between the Rules of Equity and the Rules of the Common Law with reference to the same matter, the Rules of Equity shall prevail."
[156] *Cf.* section 3.8.a, *ante*, and notes thereto.

If the surety or co-debtor remains entitled to an assignment, then it seems that his entitlement to damages from the creditor if he refuses to execute an assignment must survive.[157] In *Dale* v. *Powell*,[158] Parker J. made the following comment as to the proviso to section 5:

> "[A] point has been suggested on the construction of the Mercantile Law Amendment Act 1856, s. 5 - namely that the proviso that no co-debtor shall be entitled to recover from any other co-debtor by means of execution more than the just proportion for which, as between those parties themselves, the last mentioned co-debtor shall be justly liable, must be read as having reference to the prima facie liability at law, and not the liabilities which depend in equity upon the relations of the parties and the contract between themselves. It does not appear to me that that is the right meaning of the section."[159]

In *Brown* v. *Cork*,[160] it was held that in assessing the "just proportion" of contribution to which a surety or co-debtor was entitled from his co-surety or co-debtor, the court could not consider transactions between the parties outside of their immediate relation as co-sureties or co-debtors. There seems no reason to think that the repeal has altered the law in this regard in any way.

7.8 The Nature of the Surety's Rights prior to an Assignment

It is generally accepted that a surety has no rights in any security held by the creditor prior to payment by him.[161] There is more controversy as to the nature of the surety's rights after payment.

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[157] *Batchellor* v. *Lawrence* (1861) 9 C.B. (n.s.) 543; *Embling* v. *McEwan* (1872) 3 V.R. (L.) 52.
[158] (1911) 105 L.T. 291.
[159] (1911) 105 L.T. 291, 294.
[160] [1985] B.C.L.C. 363.
[161] In *Burgess* v. *Auger*, unreported, England, High Court, Chancery Division, Lightman J., judgment delivered on the 12th February 1998, it was held that, until a surety paid a chargee creditor, he acquired no interest in the equity of redemption. The possibility that he might pay and thereby obtain an interest was not sufficient to entitle him to complain of the activities of a receiver appointed by a prior chargee. One may also note *Malone* v. *McQuaid*, unreported, High Court, judgment of O'Sullivan J., delivered 28th May 1998 (1996 No. 392 Sp.). Similarly, *Forbes* v. *Smith*, 5 Iredell's Eq. 369; 49 Am. Dec. 432 (N.C. 1848) (surety had no right to exercise creditor's security prior to payment to the creditor); *Badger* v. *Megson* (1980) 17 R.P.R. 206, 217 (Alta. Q.B.) (the surety's right prior to payment was a personal one against the creditor to have the securities assigned to him upon payment; until the occurrence of that event, he had no interest in them). *Cf. Polk* v. *Gallant*, 2 Devereux & Battle's Eq. 395; 34 Am. Dec. 410 (N.C. 1839), where it was held that a surety for a purchaser under a court sale, where no conveyance was to take place until payment of the entirety of the purchase price, was entitled to "charge" the land for the payment of the purchase price, *prior to payment by him*, in priority to an assignee of the purchaser without notice of the surety's interest. Since the purchaser had not obtained the legal interest, it is perhaps correct to say that his assignee should take subject to existing equitable interests, even those of which he had no notice. However, it is unusual to say that the surety acquired an equitable interest prior to payment. The court explained this as arising out of the surety's undoubted anticipatory right to exoneration from the principal, coupled with the admitted insolvency of the principal in that case: "there is a plain and strong

Dixon[162] preferred the view that an actual assignment was necessary to perfect the surety's right, which otherwise remained inchoate. The reason for this was that *bona fide* purchasers or incumbrancers might become interested in the charged property without notice of the surety's interest, and they should take priority over the surety where he obtained an assignment of a prior mortgage only after they had obtained their interests. This would, presumably, only apply if the prior incumbrance had apparently been discharged. Dixon accepted that if subrogation was supposed to take place by operation of law, then, the surety's equitable claim over the security would be effective so long as the property remained in the control of the principal debtor.[163] There should, however, be no presumption that subrogation was to take place:

> "Such ... is not the just construction of the agreement between the parties, and under the civil law,[164] as well as by the law of England as settled by Lord Eldon,[165] the intention to discharge the security was presumed."[166]

Even where the surety was entitled to subrogation by operation of law, his rights were a mere equity, enforceable as against the principal and creditor only until he acquired an actual assignment, when his rights became enforceable against the world at large.[167] He also stated that "If the creditor has not made to

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equity [when it is admitted that the principal is insolvent] that such pledge should forthwith be applied to the purposes for which it was created, in discharge or diminution of the surety's responsibility" (34 Am. Dec. 410, 412 *per* Ruffin C.J.). Also, *Gee* v. *Liddell* [1913] 2 Ch. 62.

[162] *Op. cit.*, 50 *et seq.*

[163] *Op. cit.*, at 51.

[164] Referring to M. Pothier, *A Treatise on the Law of Obligations or Contracts* (translation W.D. Evans, 1806), nº 280.

[165] *Copis* v. *Middleton* (1823) Turn. & R. 224.

[166] *Op. cit.*, at 51. At 64, he states that a presumption, in case of silence, that the debt and security were to be discharged, was a more natural one. To the contrary was *Gossin* v. *Brown*, 11 Pa. 527, 532 (1849) *per* Bell J.: "It is difficult in any case to conceive the object of a surety to be extinguishment, in detriment of his own interests..."

[167] *Op. cit.*, at 52. At 78-9, he states that subrogation by operation of law can only take place subject to the equities of all parties, and is therefore no more than an "equitable proceeding by bill in favor of the surety." He concludes that therefore, on principle, relief can only be given against the parties to the original debt and their privies. However, an actual assignment would be effective to substitute the surety perfectly in the position of the creditor, and he would thus prevail over subsequent incumbrancers without notice. He also describes the surety's supposed right to subrogation by operation of law as a "*quasi* subrogation." Story, *op. cit.*, § 500, describes the surety's right in very broad terms, but he also seems to envisage an assignment to the surety: the surety

> "is also entitled to be substituted, as to the very debt itself, to the creditor, by way of cession or assignment. And *upon such cession or assignment*... the debt is, in favour of the surety, treated not as paid, but as sold; not as extinguished, but as transferred with all its original obligatory force against the principal."

(Emphasis added).

him a cession of actions, the debtor, on payment by the surety, may sell the security, if personal, to a subsequent purchaser, who, if without notice, in virtue of his legal right, will prevail over the surety."[168]

Some nineteenth century cases are consistent with Dixon's view.[169] In *Bowker* v. *Bull*,[170] Lord Cranworth V.-C. said "[t]he equity gives to the surety the right to call for a transfer of the securities, and so binds those securities into whatever hands they may come with notice of the charge."[171] In that case, it was held that the surety's right prevailed over the mortgagee creditor's right to tack further advances to his mortgage. Lord Cranworth held that the surety's right was more than a potential equity and was binding on all persons having notice on it.[172] It has similarly been said that the surety's right is enforceable against all persons claiming under the principal debtor.[173] Prior to the 1856 Act, Sir William Grant M.R. had said that in a case where a surety was such for the payment of periodic sums due, a collateral security for the payment of the sums would not return *pro tanto* to the control of the principal debtor by the payment of individual instalments.[174] In *Kennedy* v. *Campbell*,[175] Kenny J. stated that

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[168] *Op. cit.*, at 93.

[169] *Cf. Cottrell's Appeal*, 23 Pa. 294, 295 (1854), where the court said that the assignment of a judgment by a creditor to a surety gave the surety a legal right to it, as well as "an equitable right to it as a means of indemnity."

[170] (1850) 1 Sim. (n.s.) 29.

[171] (1850) 1 Sim. (n.s.) 29, 34.

[172] In *China and South Sea Bank Ltd.* v. *Tan* [1990] 1 A.C. 536, 545, Lord Templeman said on behalf of the Privy Council, "If the creditor chose to sue the surety and not pursue any other remedy, the creditor on being paid in full was bound to assign the mortgaged securities to the surety." In *Lake* v. *Brutton* (1856) 8 De G., M. & G. 440, a surety was held entitled to the delivery and assignment of a policy on the principal's life held by the creditor, though he had his own express security, and although the creditor had assigned the policy to a third party. Since it was held that the third party had had notice of the deed by which the surety had become liable, it was held that he therefore must have had notice of the surety's equity, and could not be a *bona fide* purchaser without notice. The court did not decide what the result would have been if the third party had not had notice of the surety's position. In *Drew* v. *Lockett* (1863) 32 Beav. 499, a surety had joined in a first legal mortgage of the principal debtor's interest in certain property. The property was later mortgaged to a second mortgagee by the mortgagor, without the privity of the surety. The first mortgage was paid off, partly with the surety's money, but the legal estate was transferred to the second mortgagee. Sir John Romilly M.R held that the surety's right prevailed as against the second mortgagee.

[173] *Drew* v. *Lockett* (1863) 32 Beav. 499, 505 *per* Sir John Romilly ("a surety who pays off the debt for which he became surety must be entitled to all the equities which the creditor, whose debt he paid off, could have enforced, not merely against the principal debtor, but also as against all persons claiming under him"). Similarly, *Fleming* v. *Beaver*, 2 Rawle 128, 132; 19 Am. Dec. 629, 631 (Pa. 1828) (discussed by Dixon, *op. cit.*, 80-1), and *Bowen* v. *Hoskins*, 45 Miss. 183; 7 Am. Rep. 728, 730 (1871). In *Badeley* v. *Consolidated Bank* (1888) 38 Ch. D. 238, on rather convoluted facts, it was held that the right of sureties who had paid the creditor to securities held by the creditor took priority over a garnishee of the principal debtor's rights against the provider of the security, even though the sureties had not paid the debt in full until after the making of the garnishee order.

[174] *Wright* v. *Morley* (1805) 11 Ves. 12, 23. Many American cases held, contrary to English and Irish decisions, that the payment of either a bond or judgment in which a surety was bound did not extinguish the debt and reduce the surety to the position of a simple contract creditor: Dixon, *op. cit.*, 55-6; *Lidderdale's Executors* v. *Executor of Robinson*, 12 Wheat. (25 U.S.) 594; 6 L. Ed. 740 (1827) (applying the law of Virginia), *Merchants' National Opera House* v. *Great Falls Opera House Co.*, 23 Montana 33; 75 Am. St. Rep. 499 (1899) and the cases cited *ante*.

> "The Mercantile Law Amendment Act 1856 gives a surety a statutable right, which, without the Act, a Court of equity would have worked out for him in a properly constituted suit. But in either case - if there be no voluntary transfer of securities - a suit is necessary in order to put the creditor in privity with the lands, or to clothe him with any estate or interest in them."[176]

He continued that "[u]ntil actual transfer to him of the security, or until a judgment of a Court declaring him entitled to such transfer, I am of opinion that he has no such estate or interest in the lands as would be affected by the registration of a judgment under the [Judgment Mortgage (Ireland) Act 1850]."[177]

In apparent contradiction of the above, however, there are decisions to the effect that the surety's rights will be recognised prior to an assignment as if one had already taken place. These cases can perhaps be explained as ones in which the fund the subject of the security was under the administration of the court, and an assignment was therefore regarded as a superfluity. In *Mara* v. *Ryan*,[178] decided prior to the enactment of the 1856 Act, a surety who had paid the creditor claimed to be entitled to an assignment of a judgment held by the creditor against the deceased principal debtor's estate. It was decreed that the surety was entitled to an assignment, and "to stand in [the creditor's] place for the sum paid by him on foot of the other judgment, and interest thereon." However, the court did not direct the judgment actually to be assigned, as it would cause unnecessary expense, as the property could be sold, the judgment remaining vested in the creditor as trustee for the surety.[179]

In *Silk* v. *Eyre*,[180] the successive life interests of a father and son in a certain estate were each subject to certain judgments. The judgments were discharged out of the sale of the inheritance, the son paying more than his proper proportion. It was held that the son was entitled under section 5 of the 1856 Act to be recouped this excess out of another fund which the judgment creditors had collected from the father's interest, which was lodged in court, in priority to the claim of subsequent judgment creditors of the father who had obtained a charging order over this fund. The Vice-Chancellor held that it was not

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[175] [1899] 1 I.R. 59.
[176] [1899] 1 I.R. 59, 63.
[177] *Ibid.* The Act was 13 & 14 Vict., c. 29. *Cf. Gee* v. *Liddell* [1913] 2 Ch. 62.
[178] (1838) 2 Jones 715.
[179] *Cf. Fleming* v. *Beaver*, 2 Rawle 128, 132; 19 Am. Dec. 629, 631 (Pa. 1828) *per* Gibson C.J. (cited in Dixon, *op. cit.*, 80-1):

> "an actual assignment is unnecessary. The right of substitution is everything, and actual substitution nothing. By a fiction, to which we are indebted for nearly all our equitable jurisdiction, the law has made the assignment already; and hence, the right of the party entitled by no means depends on the willingness of the creditor to transfer the security."

[180] (1875) I.R. 9 Eq. 393.

necessary for the creditor actually to execute an assignment to the over-paying co-debtor. The charging order could only attach to the fund remaining in court after the payment of the prior judgment creditors.[181] Under section 5, the prior judgments were to be considered as subsisting for the benefit of the co-debtor who claimed a contribution. The son therefore had a prior equity, which could not be displaced by a charging order which was in effect an assignment by the father himself.[182]

Similarly, in *In re McMyn; Lightbown* v. *McMyn*,[183] it was held that the representatives of a surety who had paid the common debt, but had not obtained an assignment of a judgment held by the creditor against the co-surety, were entitled to claim against a co-surety with the like priority as if they had obtained an assignment of the judgment. Chitty J. stated that

> "effect should be given to the words of the section, which say that the surety may stand in the place and use the name of the creditor; it follows that the co-surety, notwithstanding that she has neither brought an action nor had an assignment of the judgment, is entitled to obtain what she has paid in excess of her fair contribution ... [by means of the judgment]."[184]

One may contrast with the decision in *Kennedy* v. *Campbell*[185] that in *Gee* v. *Liddell*,[186] where Warrington J. stated that a surety or co-debtor who mortgaged his estate *in the same deed* as the principal or other co-debtors acquired an equitable charge by way of indemnity *from the date of the deed.* This suggested that he had an existing property interest even prior to payment.[187] *Gee* v. *Liddell* was followed and applied in *In re A Debtor (No. 24 of 1971); Ex parte Marley* v. *Trustee of the Property of the*

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[181] Under the Debtors (Ireland) Act 1840 (Pigot's Act) (3 & 4 Vict., c. 105, section 23).
[182] Similarly, *Badeley* v. *Consolidated Bank* (1888) 38 Ch. D. 238.
[183] (1886) 33 Ch. D. 575.
[184] (1886) 33 Ch. D. 575, 578. J. Phillips and J. O'Donovan, *The Modern Contract of Guarantee* (2nd ed., 1992), 573, state of this case that the paying co-surety's estate's statutory right to an assignment of the judgment would be sufficient to support a proof of debt in the estate of the other co-surety. If an actual assignment were necessary, the paying co-surety could add the costs incidental to obtaining this to her claim for contribution. Those authors state that, similarly, an actual assignment should not be necessary where a paying surety purported to exercise some or all of a creditor's rights in the bankruptcy or liquidation of a co-surety (or, presumably, principal debtor). Outside of an insolvency, however, those authors state that the paying surety should be required to obtain an assignment. Mitchell, *op. cit.*, 60, however, approves of the result in *McMyn. Cf. In re Rogers, re Rogers* (1835) 4 L.J. Bcy. 19, 21 *per* Sir John Cross, referring to a surety who had paid the creditor: "Is he not then entitled to all those rights and privileges which the original creditor held? Is not the debt transferred?" One should now see the effect of section 25 of the Companies (Amendment) (No. 2) Act 1999 (inserting a new section 25A in the Companies Act 1990), which is concerned with the rights of a surety where the principal debtor is a company under the protection of the court. The section provides that the creditor must promptly inform the surety of the holding of a meeting to consider proposals made by the examiner. Significantly, he must offer to transfer his voting rights to the surety. If the surety accepts the offer, that is effective to transfer the voting rights without the necessity for an assignment. If the creditor fails to make such an offer, he is prevented from recovering from the surety.
[185] [1899] 1 I.R. 59.
[186] [1913] 2 Ch. 62.

Debtor.[188] In that case, a father held the freehold in a house. In order to assist his son to obtain a loan, he transferred the house into the joint names of himself and the son on trust for sale, the proceeds to be held by the two as tenants in common. The father and son then charged the house to a bank, the father acting as surety. The son became bankrupt. The house was later sold. The trustee in bankruptcy claimed that the bank's security should be apportioned between the father's and son's shares of the proceeds, and that the remainder of the son's share should be available for distribution in his bankruptcy. However, it was held that, the father having charged his interest as surety, had an inchoate interest in the son's share, to ensure his indemnification. This right dictated that the bank's claim should be paid primarily out of the son's share.

Foster J. stated that if there had been no bankruptcy, the father "as a matter of marshalling," could have insisted upon the debt being discharged out of the son's share. This proposition seems unexceptionable, as an instance of the surety's right to *exoneration*.[189] However, it seems inaccurate to describe it as an instance of *marshalling*. Marshalling, as will be seen,[190] is the process by which a claimant who has only a single fund of a debtor at his disposal may claim to have been subrogated to the benefit of a claim against another fund of the same debtor held by a prior claimant who recovered his claim from the fund solely charged to the first claimant. It does not seem to describe the situation where a creditor has two funds, one belonging to the principal, one to the surety. The surety cannot force the creditor onto the fund of the principal,[191] but if his own fund is taken, he can claim subrogation to the

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[187] *Cf. ante*.

[188] [1976] 1 W.L.R. 952.

[189] *I.e.*, his anticipatory right to be relieved of liability by the principal debtor.

[190] Chapter 12.

[191] *Cf. Wright* v. *Simpson* (1802) 6 Ves. 714, 734 *per* Lord Eldon L.C.: if the surety deposited funds for payment of the creditor, and promised to indemnify him, he might require the creditor to pursue the principal; *Newton* v. *Chorlton* (1853) 10 Hare 646, 658-9; 2 Drew. 333 (note) *per* Page Wood V.-C. In general, however, neither equity nor common law recognises any analogue of the civil law benefit of discussion, under which the surety may require the creditor to pursue specified property of the principal debtor, at the surety's expense, and provided that proceedings against the principal's property will not be unduly troublesome. The benefit of discussion was introduced by Novel 4, c. 1. See J. Voet, *op. cit.*, 46.1.15; M. Pothier, *A Treatise on the Law of Obligations or Contracts* (translation W.D. Evans, 1806), n° 409 *et seq.*; *Warner* v. *Beardsley*, 8 Wendell 194, 201 (N.Y. 1831) *per* Walworth C. *Cf. Pain* v. *Packard*, 13 Johns. 174 (N.Y. 1816), where it was held that a surety could compel the creditor first to pursue the principal if the principal had at that time property sufficient to pay the debt. If the creditor did not do so, and the principal thereafter became unable to pay the debt, the surety would be held to have been discharged. In *King* v. *Baldwin*, 2 Johns. Ch. 554, 562 (N.Y. 1817), Kent C. vigorously disputed the decision in *Pain* v. *Packard*, and refused to follow it. However, on appeal (17 Johns. 384 (N.Y. 1819)), the New York Court of Errors approved of *Pain* v. *Packard*, on the casting vote of the Lieutenant Governor, the judges being equally divided. For modern Irish authority, see *Attorney General* v. *Sun Alliance & London Insurance Ltd.* [1985] I.L.R.M. 522, affirming the High Court, McWilliam J., unreported, judgment of the 14th May, 1984 (1983 No. 1435R.) and *Lombard and Ulster Banking Ltd.* v. *Murray* [1987] I.L.R.M. 522. *Pain* v. *Packard* was abrogated in New York by Section 15-701 of the New York General Obligations Law (1968). See Lachman, "Marshaling Assets in Bankruptcy: Recent Innovations in the Doctrine," (1985) 6 Cardozo L. Rev. 671, 675 note 19.

benefit of the principal's fund. It is a simpler process, though there may well be a connection.[192] The result is undoubtedly correct, though it may be doubted whether the surety really acquires a proprietary right in the principal's estate prior to payment by the surety.[193]

Although there is no Irish or English authority in point, it is thought that a surety's right of subrogation to the benefit of securities granted by the principal to the creditor is not *itself* a security which requires registration under the Bills of Sale Acts or the Companies Act 1963. The surety only acquires the benefit of the security upon payment. If the creditor failed to register the security, of course, it may be unenforceable. In the United States, it has been held that the surety's right of equitable subrogation does not require to be registered under Article 9 of the Uniform Commercial Code.[194] An express security taken by the surety from the principal does, of course, require registration,[195] and the same must be true of Irish and English law.[196]

7.9 The Securities in respect of which the Surety or Co-debtor can claim an Assignment

It was settled before the 1856 Act that the surety was entitled upon payment to any securities held by the creditor for the payment of the debt, whether or not he knew of their existence at the time when he became surety.[197] In *Newton* v. *Chorlton*,[198] Page Wood V.-C. likened the surety's contract to one of good faith, and explained the surety's right of subrogation to securities of whose existence he was unaware as deriving from a presumption that the creditor had made a full disclosure to the surety of all the

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[192] See section 12.1, *post*.

[193] Compare the cases on the point whether the single claimant has any form of interest in the other fund held by the double claimant in the context of marshalling. See section 12.1, *post*.

[194] *In re Ward Land Clearing and Drainage, Inc.* 73 B.R. 313, 316 (Bkrtcy., N.D. Fla. 1987); *McAtee* v. *United States Fidelity and Guaranty Co.* 401 F. Supp. 11, 14-15 (N.D. Fla. 1975); *In re Eastern Marine, Inc.* 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989); *Transamerica Insurance Co.* v. *Barnett Bank of Marion County* 540 So. 2d 113, 116-7 (Fla. 1989); *In re Alcon Demolition, Inc.* 204 B.R. 440, 446 (Bkrtcy. D. N.J. 1997).

[195] *In re Eastern Marine, Inc.* 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989); *Transamerica Insurance Co.* v. *Barnett Bank of Marion County* 540 So. 2d 113, 116-7 (Fla. 1989).

[196] *Cf.* the Irish case of *In re Pring, A Bankrupt* (1947) 81 I.L.T.R. 116, where the surety had taken security in the form of an assignment of the benefit of another contract which the contractor had with the owner. The surety renounced its claim to prove against the principal on foot of this contract, and was allowed to prove against the principal for indemnity in respect of the contract for which it had been surety. It was argued that the taking of express security in the form of the assignment ousted the implied right to reimbursement. Dixon J. rejected the argument. On similar facts, in *In re Eastern Marine, Inc.* 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989), the court held that the assignment was unenforceable for want of registration, but that the equitable right of subrogation survived, and did not require registration.

[197] *Aldrich* v. *Cooper* (1803) 8 Ves. Jun. 382, 389 *per* Lord Eldon L.C.; *Mayhew* v. *Crickett* (1818) 2 Swanst. 185; *Scott* v. *Knox* (1838) 2 Jones 778, 781; *Newton* v. *Chorlton* (1853) 10 Hare 646; 2 Drew. 333 (note).

[198] (1853) 10 Hare 646; 2 Drew. 333 (note), apparently affirmed on appeal (1857): see *Pearl* v. *Deacon* (1857) 24 Beav. 186, 191.

securities which he held.[199] If the creditor did not in fact make full disclosure, he should not be allowed to take advantage of his wrong, and the surety would therefore be deemed to have intended to avail of all the securities which the creditor held, whether initially known to him or not.[200] This explanation essentially derives the surety's right from an equity incorporated into the contract.

Again, prior to the 1856 Act it had been established that that a surety's right to securities acquired after he had undertaken his obligation was of the same order as his right to securities granted by the principal debtor prior to that time.[201] In *Lake* v. *Brutton*,[202] it was argued that a surety did not have a right to a security created after his contract, at least where the property had passed into the hands of a third party, but the court held that the later security was merely a perfection of a security given prior to the surety's obligation, and thus it was not necessary to decide the point.[203] However, judges in later cases[204] interpreted *Lake* v. *Brutton* as holding that the surety did have such an absolute right. In *Forbes* v. *Jackson*,[205] Hall V.-C. stated that the surety's right extended to securities created after the surety became such.[206] In *Pearl* v. *Deacon*,[207] it was held, that a surety for the repayment of a loan had been discharged *pro tanto* by the creditor's exercise of his separate right of distress over the property mortgaged by the principal for the repayment of the debt for which the surety was bound, even though the mortgage had been granted after the surety had become bound.[208]

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[199] (1853) 10 Hare 646, 649; 2 Drew. 333, 335-6 (note) referring to *Owen* v. *Homan* (1851) 3 M. & Gr. 378, 397 *per* Lord Truro L.C. (later affirmed at (1853) 4 H.L.C. 997, though without referring to this assertion).

[200] (1853) 10 Hare 646, 650; 2 Drew. 333, 336 (note).

[201] To the contrary was *Newton* v. *Chorlton* (1853) 10 Hare 646; 2 Drew. 333 (note), where Page Wood V.-C. had stated that the surety's right to previously existing securities was an equitable right superimposed upon the contract of suretyship, but that the right to after-acquired securities derived from a general rule that one who pays the debt of another is entitled to an assignment from the creditor of all the securities which he holds in respect of the debt. This bipartite theory received the approval of Dixon, *op. cit.*, 106 who stated: "The right of the surety to the benefit of securities which the debtor has by an express or implied agreement appropriated to the debt, is absolute and cannot be varied, but the nature of the creditor's lien upon securities subsequently placed in his hands, must depend upon the agreement between the debtor and creditor alone. The surety is a stranger to it."

[202] (1856) 8 De G., M. & G. 440.

[203] Furthermore, the third party was held to have had notice of the surety's right at the time when he acquired his interest. In *Wade* v. *Coope* (1827) 2 Sim. 155, Shadwell V.-C. had stated "all the notion which I have of the law is that the doctrine has always been stinted to the particular contingency of the debt being one, and the security being given for the same debt, at the time when the person became security for it." In *Newton* v. *Chorlton* (1853) 10 Hare 646, 662; 2 Drew. 333, 347 (note), Page Wood V.-C. effectively refined this holding to a proposition that the surety had no rights in respect of subsequently created securities until after he had paid the creditor.

[204] Page Wood V.-C. in *Pledge* v. *Buss* (1860) Johns. 663, 668 and Bacon V.-C. in *Forbes* v. *Jackson* (1882) 19 Ch. D. 615, 620.

[205] (1882) 19 Ch. D. 615, 619-21.

[206] See also *Scott* v. *Knox* (1838) 2 Jones 778.

[207] (1857) 24 Beav. 186, affirmed (1857) 1 De G. & J. 461.

[208] This decision was approved by the Judicial Committee of the Privy Council in *Ward* v. *National Bank of New Zealand* (1883) 8 App. Cas. 755, 765. Similarly, *Campbell* v. *Rothwell* (1877) 47 L.J.Q.B. 144;

7.9.a Mortgages

Prior to the Act, a surety was entitled to an assignment of a mortgage held by the creditor over the property of the principal debtor, and the fact of payment by the surety was no defence to the principal, as payment of itself did not discharge the mortgage; a re-conveyance by the creditor to the principal was required to have this effect.[209] The section therefore merely affirmed the pre-existing law as regards mortgages. If the creditor does not deliver the mortgage deed over to the surety after receipt of payment by the latter, the surety may compel a transfer (and seek his costs).[210]

In the Irish case *In re Davison's Estate*,[211] it was argued that the surety could only claim to stand in the position of the mortgagee as against incumbrancers of the principal whose securities were created *after* the surety undertook his obligation. Monroe J. rejected this argument, stating that the terms of section 5 were precise:

> "Thus, where a surety incurs an obligation on behalf of a mortgagor to a particular mortgagee, and discharges it by payment, he is entitled to stand in the mortgagee's shoes: he is entitled to have the mortgage assigned to him. If there be puisne incumbrancers they are not injured, as they took their security with full knowledge of an existing prior incumbrancer."[212]

Section 5 did not appear to have changed the law as respected mortgages. Consequently, even aside from the saver clause, the repeal of section 5 should not have effected any other change in the law.

It has been held that the surety's right to an assignment of a mortgage held by the creditor prevails over the creditor's right to tack later advances to the prior mortgage. One English case, *Williams* v. *Owen*,[213] had held that a surety of the mortgagor in a first mortgage could not claim an assignment of that mortgage until he had paid off later mortgages granted by the mortgagor to the same mortgagee. In that case, Shadwell V.-C. said that "the right of the sureties to stand in the place of the mortgagee, was subject to the right of the mortgagee to make a further loan to the mortgagor, and to take a further charge on the property, for securing it."[214] The sureties could have prevented this result by an express

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Leicestershire Banking Co. Ltd. v. *Hawkins* (1900) 16 T.L.R. 317. See also *Wulff* v. *Jay* (1872) L.R. 7 Q.B. 756, 764 *per* Hannen J.; *China and South Sea Bank Ltd.* v. *Tan* [1990] 1 A.C. 536, 544-5 (P.C.).

[209] *Copis* v. *Middleton* (1823) Turn. & R. 224.

[210] *Goddard* v. *Whyte* (1860) 2 Giff. 449. See also *Bushell* v. *Collett* (1861) 6 L.T. 20.

[211] (1893) 31 L.R. Ir. 249.

[212] (1893) 31 L.R. Ir. 249, 255.

[213] (1843) 13 Sim. 597.

[214] (1843) 13 Sim. 597, 598.

stipulation.[215] However, *Williams* v. *Owen* must be taken as having been overruled by *Bowker* v. *Bull*.[216] In that case, the principal debtor and sureties joined in a deed to mortgage their respective estates to the creditor. The deed provided that, without prejudice to the mortgagee's rights, as between the principal and sureties, the principal's estate should be primarily liable to pay the debt. The creditor later advanced a further sum to the principal on the security of the same estate. It was held that the mortgagee was not entitled, as against the sureties, to tack the later advances to the earlier mortgage. In *Farebrother* v. *Wodehouse*,[217] Sir John Romilly M.R. explained *Bowker* as turning on the covenant in the deed under which the principal agreed that his estate would be primarily liable to pay the mortgage debt. It is very far from clear that this could be construed as a contractual exclusion of the mortgagee's right to tack, as he seems to have thought, as the clause was expressed to be without prejudice to the mortgagee's rights. The more logical conclusion is that the decision is contradicts *Williams* v. *Owen*.[218]

In *Dawson* v. *Bank of Whitehaven*,[219] Bacon V.-C. once again held that a surety in a first mortgage was entitled to redeem the property pledged by the first mortgage, without being required to redeem a second mortgage of the same property to the same mortgagee. He felt that *Williams* v. *Owen* was irreconcilable with *Hopkinson* v. *Rolt*,[220] where it had been held that a first mortgagee could not tack further advances to his mortgage if he had notice of an intervening incumbrance at the time of the further advance. In *Williams* v. *Owen*, there was no doubt but that the mortgagee had had notice of the surety's equity to have the property conveyed to him on payment, at the time of his further advance.[221]

In *In re Kirkwood's Estate*,[222] Flanagan J. also disapproved of *Williams* v. *Owen*.[223] A surety had joined in a mortgage deed as surety only, though the deed provided that the creditor might treat him as a principal, in that he would not be discharged by the giving of time to the surety. The principal debtor later

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[215] *Higgins* v. *Frankis* (1846) 10 Jur. 328 seems to be inconsistent with *Williams* v. *Owen*, though *Williams* was not cited in it. Two had mortgaged their estates to a mortgagee, each receiving different amounts of the money advanced on foot of the mortgage. One later mortgaged his estate comprised in the earlier mortgage, with other property, to the same mortgagee, for a further sum. Wigram V.-C. held that the mortgagor who had been bound only in the first mortgage was entitled to redeem the property comprised in the first mortgage upon payment only of the sum advanced on the first mortgage. Thus, in so far as he was surety for the other mortgagor, he would succeed to the mortgage over the other mortgagor's property, in priority to the mortgagee's later mortgage.

[216] (1850) 1 Sim. (n.s.) 29. Again, it appears that *Williams* v. *Owen* was not cited.

[217] (1856) 23 Beav. 18, 29, compromised on appeal (1857) 26 L.J. Ch. 240.

[218] See also *Jones* v. *Smith* (1794) 2 Ves. Jun. 372, 375-6, where Arden M.R. stated that a co-mortgagor who was a party to one mortgage only might redeem, though his co-mortgagor later mortgaged another estate. The decision was reversed (1798 - see 2 Ves. Jun. 372, 380), the effect on this statement not being clear.

[219] (1873) 4 Ch. D. 639, overruled (without reference to this point) (1877) 6 Ch. D. 218.

[220] (1861) 9 H.L.C. 514.

[221] On appeal ((1877) 6 Ch. D. 218), it was held that the party in question was not a surety, and the question of *Williams* v. *Owen* did not therefore arise.

[222] (1878) 1 L.R. Ir. 108.

[223] (1843) 13 Sim. 597.

executed further mortgages over the same lands to the same creditor. Counsel on behalf of the creditor argued that the surety's rights under section 5 had been effectually altered by the proviso in the deed. Flanagan J., however, held that the mortgagee could not tack as against the surety in these circumstances. He approved of *Bowker* v. *Bull.*[224] He held that the position was analogous to one where the first mortgagee made a further advance having notice of an intervening incumbrance, and could not therefore claim priority for his additional advance.[225] The surety was in a similar position to the intermediate incumbrancer.[226]

It is now held that the surety's right to an assignment of a mortgage securing a debt for which he was bound prevails over the mortgagee's right to consolidate mortgages on different properties for different debts of the same debtor. In the English case of *Farebrother* v. *Wodehouse*,[227] a surety had guaranteed the payment of one of two distinct but contemporaneous loans by the same creditor, each secured upon a different property. It was held that the surety was not entitled to an assignment of the security for the loan which he had guaranteed unless he also paid the other loan.[228] Sir John Romilly M.R. held that the fact that one had become surety for one of the debts could not deprive the mortgagee of his right of consolidation (to which he referred as "his right to tack"). He seems to have treated the case effectively as one of a surety for part of a larger, single debt, parts of which were separately secured. The surety's right of subrogation was subject to "prior rights in the creditor."[229] He thought that this conclusion was supported by *Williams* v. *Owen*, showing that he had confused the doctrines of consolidation and tacking.[230] However, in the later Irish case of *In re Kirkwood's Estate*,[231] Flanagan J.

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[224] (1850) 1 Sim. (n.s.) 29.

[225] As in *Hopkinson* v. *Rolt* (1861) 9 H.L.C. 514.

[226] He also referred to *Drew* v. *Lockett* (1863) 32 Beav. 499, *Dawson* v. *Bank of Whitehaven* (1873) 4 Ch. D. 639, 649, overruled (1877) 6 Ch. D. 218 and Fisher on Mortgages (3rd ed.), 830-1. Furthermore, the creditor did not have the legal estate, and the doctrine of *tabula in naufragio* could not therefore apply. Having paid the creditor, the surety would be entitled to enforce the mortgage in the name of the mortgagee, under section 5 of the Mercantile Law Amendment Act 1856. In the later English decision of *Forbes* v. *Jackson* (1882) 19 Ch. D. 615, 621-2, Hall V.-C. similarly held that a surety in a first mortgage for the amount advanced thereon was entitled, on paying that sum, to an assignment of the mortgage even though the creditor had advanced further sums on the same security: "[The surety] is entitled to the benefit of the securities, though his payment be not made until after the time when the further advances were made by the creditor. 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." Hall V.-C. duly ordered that the mortgagee execute an assignment on receipt of the sum which the surety had guaranteed with continuing interest up to the date of payment (not the date of initial offer of payment), with a deduction for the surety's legal costs.

[227] (1856) 23 Beav. 18, 29, compromised on appeal (1857) 26 L.J. Ch. 240.

[228] Since it transpired that the creditor would be adequately reimbursed by the securities which he held, without the need for payment by the surety, the case resolved itself into a question of costs, which may reduce somewhat the weight to be attached to the judgment.

[229] (1856) 23 Beav. 18, 25.

[230] (1856) 23 Beav. 18, 28. In *In re Salmon* [1903] 1 K.B. 147, Wright J. held that the doctrine of consolidation applied to successive mortgages of a single property, which seems doubtful in the extreme: see section 11.5

expressed disapproval of *Farebrother* v. *Wodehouse*. The mortgagee's right of consolidation now only exists where the mortgagee has reserved the right in one or both of the mortgage deeds.[232]

7.9.b Payment of Preferential Debts

Where a surety was bound to the crown, either in its own right, or on behalf of others, he would normally be entitled, upon payment to the crown, or into court, to be subrogated to the crown's rights against the principal debtor.[233] At the current time, where a surety guarantees the payment of a preferential, though unsecured, debt, he will, upon payment to the creditor, succeed to the claim of the latter with the same priority.[234] So, where a director of a company guaranteed the payment of rates, and duly paid the rates to the local authority, he was held entitled under section 5 of the 1856 Act to stand in the place of the local authority, and, if need be, to use the name of the authority, to prove as a preferential creditor under section 209 of the Companies (Consolidation) Act 1908,[235] in the liquidation of the company.[236] This decision was extended in the Irish case of *In re P.J. McCourtney Ltd.*[237] In that case, on the compulsory liquidation of a company, a lease was surrendered to the lessor, who thereupon became the occupier. The local authority pursued the lessor for rates, in respect of a period prior to and subsequent to the surrender. The lessor paid the sum demanded, and then claimed in the liquidation for that portion of the rates paid which represented the period prior to the surrender. He relied on section 5, and the earlier decision. Counsel for the liquidator argued that the lessor had not been "liable with another" within the meaning of the section, as his liability had only arisen after that of the company, when he became the occupier. Budd J. held that the lessor was liable with another within the meaning of the section, and that it

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[231] (1878) 1 L.R. Ir. 108.

[232] Conveyancing and Law of Property Act 1881 (44 & 45 Vict., c. 41), section 17(2). It seems that where both mortgages are created without deed, there can be no effective reservation of the right. *Cf.* A. Lyall, *Land Law in Ireland* (1994), 761.

[233] See, *e.g.*, *R.* v. *Robinson* (1855) 1 H. & N. 275 note; *R.* v. *Fay* (1879) 4 L.R. Ir. 606; *In re Lord Churchill; Manisty* v. *Lord Churchill* (1888) 39 Ch. D. 174; *In re Russell's Estate; Dundalk Gas Co.* v. *Russell* [1933] I.R. 578. *Cf. In re Milnes Waverley Ltd. (in liq.)* [1978-80] Manx L.R. 256. In the United States, sureties for the payment of taxes are generally held entitled to subrogation to liens or other securities for payment of the taxes held by the revenue authorities: *Aetna Life Insurance Co.* v. *Middleport*, 124 U.S. 534; 8 S.Ct. 625; 31 L. Ed. 537 (1888); *Fidelity & Casualty Company of New York* v. *Massachusetts Mutual Life Insurance Co.*, 74 F. 2d 881, 883; 35-1 U.S. Tax Cas. (C.C.H.) P9298; 14 A.F.T.R. (P-H) 940 (4th Cir. 1935).

[234] At one time, crown claims were not discharged by the certificate issued by a court to an arranging banker (under (1754) 33 Geo. II, c. 14 (Ir.) and (1800) 39 & 40 Geo. III, c. 22). When a surety paid the creditors who were beneficiaries of a crown security, it was held that the surety was entitled to enforce it notwithstanding the certificate: *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205.

[235] The current equivalent provision is section 285 of the Companies Act 1963.

[236] *In re Lamplugh Iron Ore Co., Ltd.* [1927] 1 Ch. 308.

[237] Unreported, 1960, Budd J., noted, "Company Liquidation: Rates paid by Landlord," (1960) 94 I.L.T.S.J. 240.

was not necessary that his liability should have arisen at the same time as that of the principal debtor. He was therefore entitled to rank as a preferential creditor.[238]

7.9.c Other Rights to which the Surety can be Subrogated

A surety can be subrogated to a creditor's rights against a fourth party whose liability is prior to that of the surety.[239] For example, if S2 guarantees the payment of a debt in the event that P, the principal, and S1, an existing surety, do not, then, on payment to the creditor, S2 is entitled to complete indemnification from S1 (and not a mere contribution) as well as from P. In effect, S2 is a surety for S1, though the latter did not consent to the arrangement.[240] Also, if one gives a counter-guarantee to a surety to indemnify him from his liability under his guarantee, upon payment to that surety, one is subrogated to his rights against the principal. This applies equally if his rights themselves derive by subrogation from the creditor.[241]

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[238] A similar decision, also resting on the equivalent of section 5 of the 1856 Act, was *Boone* v. *Martin* (1920) 53 D.L.R. 25, discussed by Mitchell, *op. cit.*, 63-4. However, it was also held in that case, following *In re Russell; Russell* v. *Shoolbred* (1885) 29 Ch. D. 254, that the landlord could not be subrogated to a local authority's right of distress. Compare the decision in *In re Kavanagh, Ltd.* [1952] Ir. Jur. Rep. 38. In that case, the solicitor for a company which was in liquidation paid rent and rates on leasehold property in order to prevent a forfeiture of the lease. The solicitor also held shares in the company. Dixon J. held that the solicitor was not entitled to a lien on the produce of sale of the lease in respect of the payments, on the ground that, having no interest in the lease, he was a volunteer, and not a salvage creditor.

[239] See Campbell, "Nonconsensual Subsuretyship," (1935) 83 U. Pa. L. Rev. 326, 442 at 452 *et seq. Cf. Fidelity & Deposit Company of Maryland* v. *Queens County Trust Co.*, 226 N.Y. 225; 123 N.E. 370 (1919) (a surety for a trustee in bankruptcy who had paid cheques into a deposit account in an unauthorised manner was held to have been subrogated to the estate's rights against the bank which had constructive knowledge of the lack of authority). In *Fidelity & Casualty Company of New York* v. *Maryland Casualty Company*, 222 Wis. 174, 180; 268 N.W. 226 (1936), a trustee of a number of different estates had misapplied funds of the second estate. He then paid legacies which were claims on the second estate using funds misappropriated from the first estate. The trustee's surety for the first estate, having made good the loss to that estate, claimed to have been subrogated to the rights of the beneficiaries of the second estate against the trustee and the defendant surety who was liable for the trustee's defaults in respect of the second estate. It was held that the plaintiff surety was so entitled. See further on this case, *ante*. In *Fidelity & Deposit Company of Maryland* v. *Farmers' Bank of Bates County, Mo.*, 44 F. 2d 11, 25 (8th Cir., 1930), the court went to the length of stating that, as a matter of public policy, if one of a number of obligees (creditors) in a bond was a party to a wrongful act which caused an innocent obligee to suffer a loss which the surety in the bond was liable to pay, then the surety would be entitled to recover the amount it paid from the wrongdoer obligee. A different rule seems to apply in cases of insurance, where the insurer is precluded from claiming subrogation to the rights of one insured against another insured. See section 10.10.b (vii), *post*.

[240] See *Parsons* v. *Briddock* (1708) 2 Vern. 608; *Craythorne* v. *Swinburne* (1807) 14 Ves. 160; *Douglass* v. *Fagg*, 35 Va. (8 Leigh) 588 (1837); *Schnitzel's Appeal*, 49 Pa. 23 (1865); *In re Barned's Banking Co.; Ex parte the Bank of London* (1869) 21 L.T. 126; *Raffle* v. *A.G.C. (Advances) Ltd.*, unreported, Supreme Court of New South Wales, Equity Division, Young J., 1989 N.S.W. LEXIS 11250; BC8901727, judgment delivered on the 13th September 1989.

[241] *Brown Shipley & Co. Ltd.* v. *Amalgamated Investment (Europe) B.V.* [1979] 1 Lloyd's Rep. 488.

A surety for a person in a fiduciary position may be subrogated to the creditor's rights against third parties who were parties to the breach of fiduciary duty.[242] It is possible to be subrogated to a right to trace.[243] One author expressed the view that where the fund into which he traced increased in value, the surety, who bore the risk, was entitled to the surplus beyond the sum which made good the creditor's loss.[244] This conflicts with the general rule that the surety may recover no more than the amount of his loss.[245] One may compare the rule in insurance, which is that the insurer is not allowed to make a profit, even though he bears the risk.[246]

7.9.d Rights to which the Surety may not be subrogated

It has been held that a lessor's right of distress is not a security or remedy to the benefit of which the surety, or one in similar position, is entitled upon paying the rent. In *In re Russell; Russell* v. *Shoolbred*,[247] an assignor of sub-leasehold interests in four premises was compelled to pay rent to the sub-lessors after the assignment. He later acquired the sub-lessors' interest (*i.e.*, the head leasehold interest) in three of the premises, and further (subsequent) sub-leasehold interests in all four of the premises. When he acquired the further sub-leasehold interests, he covenanted to pay the rents reserved by the first (higher) sub-leases. He later assigned the sub-lessors' interests (*i.e.*, the head leases) in the three premises to a third party, along with his interest in the further sub-leasehold of the fourth premises. In an action on a covenant by the assignor against his immediate assignee for reimbursement of the rent which he had paid, it was held that the assignee had not been discharged by the assignor's dealings with the properties. The assignee had argued that he had been discharged on a number of grounds. First, it was said that he had been discharged because the assignor had covenanted to pay the rent under the sub-leases. Then, it was said that the assignee had been discharged when the assignor obtained assignments of the further sub-leasehold interests. By doing this, the assignor had prevented himself, or the assignee (if he paid the rent, or reimbursed the assignor) from availing of the sub-lessors' right of distress; the assignor could not exercise this right against himself. The right of distress was said to be a proceeding at law or a remedy to which the assignee would have been entitled under section 5 of the 1856 Act upon payment.

The Court of Appeal held that first, the payment of rent by the assignor had created no lien on the sub-lease which could have been destroyed by merger when the assignor obtained the sub-lessors' interests.[248] Secondly, the assignee could have had no right of subrogation under section 5 to the sub-

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[242] *Asberry's Administrator* v. *Asberry's Administrator*, 74 Va. (33 Gratt.) 463, 471 (1880).
[243] *Incorporated Law Society of Ireland* v. *Owens*, unreported judgment of Hamilton P., 11th January, 1989, noted (1990) 8 I.L.T. 64.
[244] Campbell, *op. cit.* at 460.
[245] See *ante*.
[246] *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330.
[247] (1885) 29 Ch. D. 254.
[248] (1885) 29 Ch. D. 254, 262.

lessors' right of distress. The right of distress had been extinguished by the payment by the assignor. The right of distress could not be the subject of an assignment at common law, and the court read section 5 as applying only to securities which were, according to the existing law, assignable by their nature. The court also held that the "remedies" to which section 5 referred were limited to "proceedings at law or in equity in which, but for the statute, the payment might have been pleadable," which could not have been the case as regarded a distress.[249]

7.10 The Rights of the Surety for a Debtor where the Creditor had a right to marshal

There are occasional references in cases and texts to the surety's "right to marshal." This is generally used to mean his right to exoneration or subrogation. The surety does not have a general right to compel the creditor to seek recourse first from the principal or from securities held by the creditor. However, in limited circumstances, the surety can in effect acquire a right to marshal. This occurs where a surety pays a creditor who had a right to have securities marshalled. If the surety is subrogated to the position of the creditor, he may be able to avail of the creditor's ability to have the securities marshalled. So, if a debtor mortgaged Blackacre and Whiteacre to A., and the debtor then mortgaged Blackacre alone to B., for which transaction S. stood as surety for the debtor, then, on paying B., the surety will be subrogated to his rights under the mortgage, including his right to have A.'s mortgage marshalled.[250]

7.11 The Surety's Proprietary Rights over Funds held *by the Creditor*

Where an insured recovers from a third party in respect of an insured loss, and the insurer has already paid him, it has been held that the insured holds the sum recovered subject to an equitable lien in favour of the insurer.[251] In respect of a surety, there is some authority to suggest that he enjoys proprietary

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[249] The decision was followed in *Boone* v. *Martin* (1920) 53 D.L.R. 25.

[250] *Heyman* v. *Dubois* (1871) L.R. 13 Eq. 158; 25 L.T. 558, though in that case, A. and B. were the same party, with two different mortgages over funds of the debtor, who would thus have not have had any motive for marshalling. The mortgages also gave the mortgagee a right of consolidation. The surety argued that he was also subrogated to this right to consolidate. Bacon V.-C. did not advert to this latter point. *Cf. Wagner* v. *Elliott*, 95 Pa. 487 (1880). In that case, a prior creditor had a disputed right to a second fund. He was paid out of the first fund, disappointing a later creditor who could only look to the first fund as security, but who was later paid in full by a surety. At the time when the prior creditor received payment, he had failed in his attempt to establish his claim on the second fund, although a new trial of the matter had been ordered. The surety claimed to have been subrogated to the later creditor's right of subrogation to the prior creditor's rights against the second fund. It was held that he had not been so subrogated, the court regarding subrogation as in effect a remedy, which would not be granted in this case as it would be unduly harsh on the parties who had successfully defended the first creditor's claim to the second fund, and their surety on a bond to deliver the fund to the sheriff if so ordered by the court. The decision seems wrong. It could perhaps have been justified if the parties who had established their right to the second fund and their surety could claim to have changed their position in reliance on the satisfaction of the prior creditor. In any event, that was not the case.

[251] See section 10.7, *post*.

rights over funds received by the creditor after he has paid the creditor. So, in *Ex parte Rushforth*,[252] Lord Eldon held that a creditor who has presented a proof in the bankruptcy of the principal, and has then been paid by a surety the entire of the amount which the surety guaranteed, holds his proof and any dividends received thereon in trust for the paying surety.[253] In *Mara* v. *Ryan*,[254] the Irish Court of Exchequer held that a surety was entitled to stand in the place of a judgment creditor as against the estate of the principal debtor. They stated that the property should be sold, with the creditor retaining the judgment for the time being as trustee for the surety.[255] In *China and South Sea Bank Ltd.* v. *Tan*,[256] Lord Templeman said on behalf of the Privy Council (*obiter*) in a case where a creditor held a mortgage over the principal debtor's property:

> "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 of the mortgaged securities to procure recovery of the whole or part of the sum he has paid to the creditor."[257]

(i) Performance Bond Sureties

In the context of sureties for building contractors, it appears to be generally recognised that the surety has an equitable lien over funds retained by the owner for completion of the contract, if the surety completes the contract or causes it to be completed.[258] As against other creditors of the *contractor*, it has been said that the surety is entitled to priority even over registered secured creditors on the ground that, but for the surety's acts in completing the contract, the moneys would never have become owing to the contractor.[259] Thus,

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[252] (1805) 10 Ves. 409.
[253] Similarly, *Ex parte Wood* (1791) cited in *Ex parte Rushforth* (1805) 10 Ves. 409, 420 *per* Lord Eldon L.C., where it was said that the surety might compel the creditor to prove in the bankruptcy, and to become a trustee of the amount of such dividends for the surety.
[254] (1838) 2 Jones 715.
[255] Note also *Scott* v. *Knox* (1838) 2 Jones 778, 781, where counsel for the surety argued that once the surety had paid the creditor, the latter became a trustee of a mortgage which he held against the principal debtor, for the benefit of the surety. The court did not refer to this specific assertion. Goff and Jones, *op. cit.*, 446, 448, note 79, state that if the holder of a bill of exchange receives part payment from an indorser and then recovers the full amount of the bill from the acceptor, he holds an amount equal to that paid by the indorser on trust for the indorser (citing *Jones* v. *Broadhurst* (1850) 9 C.B. 173).
[256] [1990] 1 A.C. 536.
[257] [1990] 1 A.C. 536, 545. See also *Ulster Bank* v. *Lambe* [1966] N.I. 161, 169 *per* Lowry J.
[258] See, *e.g.*, *Pearlman* v. *Reliance Insurance Co.* 371 U.S. 132, 137 (1962); *In re Alcon Demolition, Inc.* 204 B.R. 440, 447 (Bkrtcy. D. N.J. 1997).
[259] *In re Alcon Demolition, Inc.*, 204 B.R. 440, 447 (Bkrtcy. D. N.J. 1997); *Jacobs* v. *Northeastern Corporation*, 416 Pa. 417; 206 A. 2d 49 (1965).

"When the surety performs in the place of a debtor and completes the contract, the entitlement to contract funds arises. However, equity demands that the debtor not receive a windfall. Thus, subrogation places the surety in a position to exercise the debtor's rights to identifiable contract funds, effectively removing that property from the estate and rendering it unavailable to general creditors."[260]

This conclusion is eminently justifiable without recourse to issues of priority, if the view is taken that the surety is subrogated to the owner's rights as against the contractor. The owner is not obliged to pay at all if the contract has not been performed. Therefore, it has been argued that the surety is merely subrogated to the owner's rights against the contractor.[261]

(ii) Sureties for the payment of premiums on Insurance Policies

Where sureties for the payment of premiums on an insurance policy which was mortgaged to certain uses paid premiums on the policies, and the mortgagee was duly paid in full, it was held that the sureties were entitled to a lien on the proceeds of the policy to reimburse them their payments with interest.[262] Kindersley V.-C. said of the sureties, "if they did pay, it appears to me clear that they would be entitled, not on moral grounds, nor on the doctrine of salvage (if there is such a doctrine); but inasmuch as between them and [the principal debtor], if they paid for him, they had a *lien* on his equity of redemption on the surplus due..."[263] Again, in this case, one suspects that if the mortgagee of the policy had paid the premiums, he would have been permitted to add the sums so paid to his debt secured by the policy.[264] Thus, the surety's right can be seen as one of subrogation to the mortgagee's rights over the proceeds of the policy. It seems that, prior to payment, the surety does not have any proprietary rights over securities

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[260] *In re Alcon Demolition, Inc.*, 204 B.R. 440, 447-8 (Bkrtcy. D. N.J. 1997). This line of reasoning, and the general recognition of the construction bond surety's right of subrogation receive trenchant criticism from Walt and Sherwin, "Contribution Arguments in Commercial Law," (1993) 42 Emory L.J. 897, 953-7.

[261] Mungall, "The Subrogation Rights of the Contract Bond Surety: Some Basics," in Tort and Insurance Practice Section, American Bar Association, *Subrogation Rights of the Contract Bond Surety* (1991), 1 at 7-9.

[262] *Aylwin* v. *Witty* (1861) 30 L.J. Ch. 860.

[263] (1861) 30 L.J. Ch. 860, 861. In fact, one of the sureties had requested a third party to pay certain of the premiums, and had purported to assign his interest in the policy to the third party. It was held that this was effective to permit the third party to have the benefit of the lien which the surety would have had if he had paid out of his own funds. Kindersley V.-C. added (*loc. cit.*) : "Even if [the third party] had paid them voluntarily, he had gained such an interest as justified him in seeing that they were kept up; and the creditors cannot take the money and deprive him of those payments."

[264] There would often be an express provision to that effect in a mortgage deed. The terms of the mortgage are not recited in the report. However, it seems possible that such a provision could be implied at law.

held by the creditor. Thus, a payment by the surety could not be regarded as a "salvage" payment, even if a court is willing to acknowledge such a jurisdiction.[265]

7.12 The Extent of the Surety's or Co-debtor's Rights

The proviso to section 5 states that a surety may recover from his co-surety no more than the just proportion for which the co-surety was justly liable. In England, the Court of Appeal has held that this referred solely to the co-surety's portion of the debt, and that it excluded any consideration of transactions outside of the suretyship. Thus, if a paying surety was indebted to a contributory co-surety on a separate account, this was irrelevant in considering the extent to which the paying surety could avail of the creditor's securities to enforce payment from the contributory co-surety.[266]

Furthermore, a surety claiming contribution under section 5 is entitled to prove in the bankruptcy or liquidation of his co-surety for the full amount of the debt; this is the right given by the body of section 5. In *In re Parker; Morgan* v. *Hill*,[267] it was held that the proviso only restricted the surety from recovering more than his proper proportion; so, if he obtained an assignment from the creditor, he might prove for the whole, though his dividend could not exceed the share properly due to him from the insolvent co-surety.[268] It appears that if the surety merely sued the co-surety for a contribution without first obtaining an assignment, he might be limited to proving for the amount of the co-surety's proper share.[269]

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[265] As to salvage payments, see section 4.6, *ante*. *Cf. Foskett* v. *McKeown* [1997] 3 All E.R. 392, 402 *per* Scott V.-C.: "If an individual intentionally pays a premium on a policy that belongs to someone else, there is no reason why equity should come to his assistance and give him an interest in the policy" (referring to *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234). *Aylwin* v. *Witty* is most similar to Fry J.'s third category in his (later) list of cases where a payer might acquire a lien on the proceeds of a policy in *In re Leslie; Leslie* v. *French* (1883) 23 Ch. D. 552, 560, *i.e.*, that where a third party advances money to trustees for the preservation of the trust property, and is subrogated to the trustees' lien over the property for moneys spent by them in the preservation of the property.

[266] *Brown* v. *Cork* [1985] B.C.L.C. 363. Compare the decision of the Supreme Court of New South Wales in *A.E. Goodwin Ltd. (in liq.)* v. *A.G. Healing Ltd. (in liq.)* (1979) 7 A.C.L.R. 481, 489, in which a co-surety who had paid more than his share to the creditor was held to have been subrogated to the creditor's rights against the principal even though the principal had a separate claim against him which exceeded the amount of his claim. Another co-surety also had a claim against the overpaying co-surety. It was again held that this could not be set off against the paying surety's claim for contribution. One reason given was that the right of subrogation was a "class right" available to all of the sureties who had paid the creditor. Therefore, this joint claim could not be the subject of a set off of an "individual claim" by the principal debtor or a individual co-surety. See P.R. Wood, *English and International Set-Off* (1989), § 10-161.

[267] [1894] 3 Ch. 400.

[268] *In re Parker; Morgan* v. *Hill* [1894] 3 Ch. 400, 404-5 *per* Kekewich J., affirmed by the Court of Appeal at 405-407. Kekewich J. stated that the question which arose concerned the right of action, not the amount of the recovery. He followed the earlier decision of *Ex parte Stokes* (1848) De G. 618, which predated the statute.

7.13 Limitations on the Surety's Rights under Section 5

The surety will still only be entitled to the benefit of securities held by the creditor which would actually be of use to him in recovering an indemnity from the principal or a contribution form his co-sureties. Thus, where the creditor held a security solely against the paying surety, he could not claim an assignment of it (though he might be entitled to have it discharged). So, in *Hardy* v. *Johnston*,[270] a creditor had recovered judgment against a surety as a sole defendant. It was held that the surety was not entitled to an assignment of the judgment upon payment, as he could not enforce it against anyone else. Stawell C.J. stated: "Holding a judgment is intelligible, as long as it is unsatisfied as against anyone."[271] The proviso to the section showed that it referred to judgments which, though technically satisfied by payment by the surety, could still be enforced against co-defendants for a contribution.[272]

7.13.a Contractual Waiver or Exclusion

Given that the surety's right under section 5 was one for his private benefit, it could be waived or excluded by agreement.[273] However, it was not clear whether the simple provision of an express means of recourse against the principal debtor was sufficient to exclude the surety's statutory rights. In the early case of *Toussaint* v. *Martinnant*,[274] decided prior to the statute, it was held that a surety had excluded his common law right to indemnification by taking a bond to secure himself. This case was later disapproved in Ireland,[275] on the ground that at the time of the decision in *Toussaint*, the surety's common law right to indemnification had not long been established, and that there was no inconsistency between a right to recover on a bond and a quasi-contractual right of indemnity. In that case, the surety on a performance bond by a contractor had taken the right to call for an assignment of the benefit of that contract and of another contract between the contractor and the same owner. This security was held not to be inconsistent with the retention of the common law right to reimbursement.[276]

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[269] *In re Parker; Morgan* v. *Hill* [1894] 3 Ch. 400, 407 *per* Davey L.J. The decision received the approval of Murphy J. in *In re P.M.P.A. (Longmile) Ltd.* [1993] 1 I.R. 190.

[270] (1880) 6 V.L.R. 190.

[271] (1880) 6 V.L.R. 190, 192.

[272] He added (*ibid.*): "The present plaintiff [the surety] could not stand in the place of the creditor as against himself. That is the effect of the observations in *Silk* v. *Eyre* [(1875) I.R. 9 Eq. 393, 395]." Stephen J. noted that

> "We are assisted in arriving at the meaning of the enactment, by recollecting that it is intended to furnish a summary mode of carrying out the principles of equity in a contribution suit, which differed from law in principle and in the *modus operandi*..."

[273] *Cf.* J. Phillips and J. O'Donovan, *The Modern Contract of Guarantee* (2nd ed., 1992), 561.

[274] (1787) 2 T.R. 100.

[275] *In re Pring, A Bankrupt* (1947) 81 I.L.T.R. 116, 119 *per* Dixon J.

[276] The much more recent decision in the American case of *In re Eastern Marine, Inc.* 104 B.R. 421 (Bkrtcy., N.D. Fla., 1989) seems to accord with this decision. See *post.* In *Gossin* v. *Brown*, 11 Pa. 527

To the extent that section 5 can be regarded as still of effect, one would think that the courts would be even more loath to hold that a surety has waived his right under it. In an early case, *Cooper* v. *Jenkins*,[277] it was held that by taking a mortgage to secure his indemnification, a surety had waived his entitlement under section 5 to an assignment of a mortgage granted by the principal to the creditor. One may, however, compare the almost contemporaneous decision in *Brandon* v. *Brandon*,[278] where a receiver of an estate gave his sureties a security on part of the estate which had descended to him as an indemnity. He also purchased other parts, which were not comprised in the indemnity. It was held that the persons entitled to the estate over which the receiver had been appointed were entitled to a lien on all of the receiver's estate. The sureties having made good the default of the receiver, were held to be entitled to the lien on both the portion of the estate over which they held security, and the part which the receiver had purchased. The Court of Appeal in Chancery held that the sureties had not waived their right of subrogation to the lien on the purchased part of the estate, in the absence of express words of release of that right in the deed by which they took their restricted security.

Recent case law also suggests that the mere taking of security of itself will not oust the surety's right under section 5.[279] In *In re Chipboard Products Ltd. (in liquidation)*,[280] Barr J. held that the fact that a surety had taken a limited security did not affect his right of subrogation to a greater security held by the creditor.[281] This applied both to the surety's equitable right and to his statutory right under section 5.

(1849), a surety took assignments of choses in action as security for his indemnification at the time when he confessed judgment to the creditor. He later paid the debt in full, and, after a period of two months, requested and received an assignment of a mortgage held by the creditor. It was held that he had not waived his right of subrogation by taking the security, or by failing to request the assignment immediately upon payment by him. Bell J. said (at 533) "In accepting additional means of safety, it is not to be supposed he intended to extinguish those he already possessed." Compare, however, *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.* [1984] B.C.L.C. 27, 36 *per* Oliver L.J. (reversing [1984] B.C.L.C. 1, affirmed on different grounds, [1984] B.C.L.C. 259): "I am far from convinced, all other considerations apart, that the equitable principle [of subrogation] applies where the payer has already a full and independent right of recovery against the debtor." Kerr L.J. also said (at 50), "Given the existence of the express counter-indemnities ... I cannot see any scope for any parallel implication of a right of subrogation to the same effect as the counter-indemnities." That case was unusual, however, as the payer had agreed to pay a fourth party in the event that the "principal debtor" defaulted. The fourth party was then bound to pay the creditors.

[277] (1863) 32 Beav. 337.

[278] (1859) 3 De G. & J. 524.

[279] It may also be noted that many standard form guarantees provide that if the surety takes security from the principal debtor for his indemnification, he will not be allowed to enforce it against the principal in competition with the creditor, and both the security and any monies recovered from the principal on foot of it will be held by the surety on trust for the creditor until the creditor has received payment in full.

[280] Unreported, 1984 No. 7316 P, judgment of Barr J., 20th October, 1994.

[281] Barr J. held that there was no inconsistency between this holding and the decisions in *Highland Finance Ireland Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1992] 1 I.R. 472 (Murphy J., later affirmed by the Supreme Court, [1998] 2 I.R. 180), and *Bank of Ireland Finance Ltd.* v. *D.J. Daly Ltd.* [1978] I.R. 79. This seems to be correct. The cases cited concerned the question whether a lender which had taken a specific security or contract for repayment could claim to have been subrogated to a security

Thus, he was entitled to recoupment out of the assets over which the creditor had held a charge but which had been outside his own charge.

Standard form guarantees used by financial institutions commonly restrict the surety's rights.[282] It is standard to provide that the creditor should be at liberty to treat the surety in all ways as a principal debtor, and that the surety should not be discharged in whole or in part by any conduct on the part of the creditor which is prejudicial to the surety, whether by way of dealing with securities given by the principal debtor or by extending further time for payment to the principal. Such guarantees invariably provide that the surety should not be at liberty to recover from the principal debtor or be subrogated to the position of the creditor until such time as the creditor has recovered in full from the principal debtor.

As was stated in section 1.3, restitution lawyers generally regard the existence of a contractual recourse as a bar on analogous restitutionary relief. The body of cases discussed here envisages the co-existence of contractual and non-contractual recourse against a principal debtor. Therefore, commentators who describe the surety's rights against the principal as being directed to reversing an unjust enrichment tend to dismiss the cases cited as wrongly-decided.[283] However, it was well said in *Gossin* v. *Brown*:[284] "In accepting additional means of safety, it is not to be supposed [the surety] intended to extinguish those he already possessed." It is felt that this persistence of the surety's right to indemnification is an indication that it is is not solely directed at the reversal of an unjust enrichment.

7.14 Discharge of the Surety through Interference with his right of Subrogation

If the creditor releases or otherwise impairs a security which he held for the repayment of the debt, and to which the surety might have claimed to be subrogated upon paying the debt, the effect will be to release the surety.[285] He need not show actual proof of loss.[286]

7.15 Appraisal of the Surety's Right of Subrogation

The surety's right of subrogation, as has been seen, is extremely broad, and extends to all securities held by the creditor for the same debt and permits the surety to succeed to any priority which

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which had been discharged out of the funds which it had advanced. By contrast, in the surety cases, the surety has an undoubted equitable and statutory right which exists in all cases where he has not waived it. It is therefore legitimate to state that any waiver of his right must be unequivocal.

[282] *Barclays Bank Ltd.* v. *T.O.S.G. Trust Fund Ltd.* [1984] B.C.L.C. 27, 41 *per* Oliver L.J. (reversing [1984] B.C.L.C. 1, affirmed on different grounds, [1984] B.C.L.C. 259).

[283] Goff and Jones, *op. cit.*, 48-53; O'Dell, [1993] Rest. L. Rev. § 161 (on *Highland Finance Ireland Ltd.* v. *Sacred Heart College of Agriculture Ltd.* [1992] 1 I.R. 472, later affirmed [1998] 2 I.R. 180).

[284] 11 Pa. 527, 533 (1849) *per* Bell J.

[285] *Hayes* v. *Ward*, 4 Johns. Ch. 123, 129-130 (N.Y. 1819).

[286] *Northern Banking Co., Ltd.* v. *Newman* [1927] I.R. 520.

the creditor possessed. Mitchell[287] criticises the general availability of subrogation to proprietary or preferential claims, notwithstanding the statutory basis which exists for such subrogation in England. Since the surety is legally obliged to pay the creditor, he cannot claim to have retained any proprietary interest in the money which he pays to the creditor. Mitchell does not accept that the surety can be said not to have voluntarily accepted the risk of the principal's insolvency. There is therefore no reason to prefer him to other creditors of the principal. Again, Mitchell does not accept that, in general, it should be deemed to have been the mutual intentof the parties that, on payment, the surety should be entitled to the benefit of all securities or privileges possessed by the creditor.[288]

The justification for allowing subrogation of the surety to a secured claim of the creditor is often said to be that subsequent incumbrancers cannot be prejudiced, as they must be taken to have known of the prior incumbrance, and it is all the same to them whether the original creditor or a surety is entitled to the benefit of it.[289]

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[287] *Op. cit.*, 53, 59.
[288] See also Burrows, *The Law of Restitution* (1993), 83.
[289] *Drew* v. *Lockett* (1863) 32 Beav. 499, 505 *per* Sir John Romilly M.R. See also section 3.9, *ante.*

CHAPTER 8

THE SUBROGATION OF VENDORS OF INCUMBERED ESTATES

8.1 The General Paradigm

This section deals with two factual situations, both involving the sale of an incumbered estate. In the first situation, the vendor sells an estate which is subject to incumbrances. The purchaser does not, however, enter into any covenant with the vendor or with chargees or creditors to pay off those incumbrances. The rights of the vendor in such a case if he is required to pay an incumbrancer are considered below.

The second situation also involves the sale of an incumbered estate. In this case, however, the purchaser *does* undertake to the vendor to pay off the incumbrances. The rights of the vendor in such a case will be considered, as will the question whether or not the creditor can enforce his claim directly against the purchaser.

This category of case is one where, strictly, there is only one debtor liable to the creditor, *i.e.*, the mortgagor, so there may be a theoretical difficulty in saying that the objective is to shift liability onto the primarily liable party. However, it may be regarded as a case where, through a change of circumstances after the debtor becomes liable, he acquires a right of indemnity against another party or a certain fund.

8.2 Purchasers who have not assumed the payment of incumbrances on the estate

Numerous decisions establish that a purchaser of an incumbered estate, although he does not undertake to pay the secured debts, nonetheless owes an implied duty to his vendor to indemnify him against the burden of those incumbrances.[1] This is sometimes expressed to be on the basis that the land,

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[1] The *locus classicus* is the statement of Lord Eldon L.C. in *Waring* v. *Ward* (1802) 7 Ves. 332, 337. Having stated that the purchaser intended to buy subject to the mortgage, without having incurred a personal obligation in respect of the mortgage debt, he continues:

> "If he enters into no obligation with the party from whom he purchases ... to save him harmless from the mortgage, yet this Court, if he receives possession and has the profits; would independent of contract, raise upon his conscience an obligation to indemnify the vendor against the personal obligation to pay the money due upon the vendor's transaction of mortgage; for being become owner of the estate, he must be supposed to intend to indemnify the vendor against the mortgage."

This statement has been approved and applied in numerous later cases: *Vandeleur* v. *Vandeleur* (1835) 3 Cl. & F. 82, 99; 9 Bl. (n.s.) 157, 177-180; Ll. & G. *temp.* Sugden 241n., 244, *per* Lord Brougham; *Jones* v. *Kearney* (1841) 1 Dr. & War. 134, 156 *per* Sir Edward Sugden L.C.; *Thompson* v. *Wilkes* (1856) 5

which the purchaser has only bought subject to incumbrances, remains the "primary fund" for the payment of the incumbrances.[2] It may be presumed that the price which the purchaser pays for the estate reflects the existence of the burdens on it. The greater number of judicial observations relate to the situation where a mortgagor conveys the land to a purchaser *subject to the mortgage*. This will not make the purchaser liable to pay the mortgage debt to either the vendor or the mortgagee. However, if the mortgagee claims from the mortgagor, the latter will be entitled to be reimbursed by the purchaser.[3] A similar doctrine applies in the case of the assignment of a lease subject to incumbrances[4] and of the sale of land subject to an annuity.[5]

The vendor's right to indemnification is an equitable one, and binds third parties who purchase the land with notice of it. Notice will normally be implied from the nature of the former sale. An illustration is provided by the case of *Jumel* v. *Jumel*,[6] in which a mortgagor had conveyed land to a trustee for his wife, subject to the mortgage. Later, all three parties conveyed to B., subject to the mortgage. B. later conveyed to W. for nominal consideration, in trust for the mortgagor's wife. This conveyance was not stated to be subject to the mortgage. On the mortgagor's death, his wife became administratrix of his estate. She paid off the mortgage debt, and now sought to claim that amount from the mortgagor's personal estate. She was held not to be entitled to reimbursement. Walworth C. held that the conveyance to B. subject to the mortgage had the effect of obliging B. to discharge the mortgage, as a result of the implied duty to indemnify. If B. had allowed the mortgagee to collect the debt from the

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Grant (Ont.) 594, 595 *per* Blake C.; *Boyd* v. *Johnston* (1890) 19 O.R. 598; *Walker* v. *Dickson* (1892) 20 O.A.R. 96, 102 *per* Burton J.A.; *In re The Law Courts Chambers Co., Ltd.* (1890) 61 L.T. (n.s.) 669, 671 *per* Stirling J.; *Adair* v. *Carden* (1892) 29 L.R. Ir. 469, 484 *per* Porter M.R.; *Mills* v. *United Counties Bank Ltd.* [1912] 1 Ch. 231, affirming [1911] 1 Ch. 669; *Herle* v. *Lessemeister* [1925] 3 W.W.R. 609; *Hayward* v. *Disney* [1925] 3 D.L.R. 989, 994-7 *per* Latchford C.J.; *Simpson* v. *Forrester* (1973) 132 C.L.R. 499, 507 (*per* Barwick C.J.), 514 (*per* Gibbs J.); *Reid* v. *Royal Trust Corporation of Canada* (1985) 20 D.L.R. (4th) 223. In *Dodson* v. *Downey* [1901] 2 Ch. 620, it was held that the purchaser of a share in a partnership had personally to indemnify the vendor against liabilities of the partnership.

[2] *Cf., e.g., Alen* v. *Hogan* (1835) Ll. & G. *temp.* Sugden 231, 239 *per* Sugden L.C.: "when a man gives an estate to another, on condition that he pays the debts which affect it, it is clear that the estate is the proper fund for the payment of those debts"; *Tice* v. *Annin*, 2 Johns. Ch. 125 (N.Y. 1816); *Bigelow* v. *Bush*, 6 Paige Ch. 343, 346 (N.Y. 1837) *per* Walworth C.; *Cox* v. *Wheeler*, 7 Paige Ch. 248 (N.Y. 1838); *Jumel* v. *Jumel*, 7 Paige Ch. 591 (N.Y. 1839); *Brewer* v. *Staples*, 3 Sandf. Ch. 579 (N.Y. 1846); *Johnson* v. *Zink*, 51 N.Y. 333, 336 (1873); *Murray* v. *Marshall*, 94 N.Y. 611 (1884).

[3] If the purchaser re-sells to the vendor, he ceases to be liable to indemnify the vendor, as the latter will be presumed to have covenanted in turn to indemnify the purchaser. In *Ashby* v. *Jenner* (1888) 32 S.J. 576, a purchaser had bought land subject to a mortgage, expressly covenanting to indemnify the vendor. The purchaser later re-conveyed to a third party nominated by the vendor, the third party covenanting to indemnify the purchaser. The security proving insufficient, the vendor was forced to pay the deficiency, and claimed indemnification from the purchaser. It was held that, as the re-sale had effectively been to the original vendor, though, at his order, made to a third party, the purchaser's covenant had been extinguished by the implied covenant by the vendor to indemnify the purchaser upon the re-sale.

[4] *Jones* v. *Kearney* (1841) 1 Dr. & War. 134, 155-6 *per* Sir Edward Sugden L.C.

[5] *Harrisson* v. *Duignan* (1842) 2 Dr. & War. 295, 303-4 *per* Sir Edward Sugden L.C.

[6] 7 Paige Ch. 591 (N.Y. 1839).

mortgagor, the mortgagor would have been subrogated to the mortgagee's rights against the land.[7] Therefore, the mortgagor had an equitable right to have the debt paid from the land in B.'s hands.

W. had constructive notice of the mortgagor's equitable right.[8] The *cestui que trust*, the mortgagor's wife, had actual notice of the mortgagor's right, as she had been a party to the conveyance to B. Therefore, the land in W.'s hands remained charged with the debt. It seems that the legal estate had become vested in the *cestui*, the mortgagor's wife. She should therefore have paid the debt out of that property, "which was the primary fund for that purpose," rather than paying it out of the mortgagor's estate.[9]

Where a mortgagor conveys part of the mortgaged estate subject to the mortgage, and retains the remainder, it has, however, been held that each part of the estate should contribute rateably. In *In re Mainwaring's Settlement Trusts, Mainwaring's Trustee in Bankruptcy* v. *Verden*,[10] a mortgagor mortgaged both (a) an insurance policy and (b) an interest under a settlement in order to secure a debt. The interest under the settlement was later sold subject to the mortgage. In due course, the mortgage was realised entirely out of the policy moneys. The trustee in bankruptcy of the mortgagor, representing the interest of the latter, then claimed to recover from the purchaser of the settlement interest the amount which had been paid out of the policy moneys. He argued that as the purchasers of the settlement interest had bought expressly subject to the mortgage, they were obliged to indemnify the estate of the vendor.[11] Counsel for the trustee[12] contended that

> "The trustee in bankruptcy ... is entitled to be subrogated to the rights of the mortgagees as against [the interest under the settlement] ... which had been sold and assigned to the purchasers merely as an equity of redemption and expressly subject to the mortgage ... The trustee is therefore entitled to stand in the shoes of the mortgagees to be recouped out of the settlement interests."[13]

In view of the fact that both the property retained by the mortgagor (the policy) and that sold (the settlement interest) had been liable to pay the mortgage debt, the Court of Appeal had little compunction

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[7] See *post.*

[8] It was said to be evident on the face of the conveyance to B. That is, W. must have known from the nature of the original sale subject to the mortgage that B. was bound to indemnify the mortgagor.

[9] See also *Bigelow* v. *Bush*, 6 Paige Ch. 343, 346 (N.Y. 1837) *per* Walworth C.: "So far as the rights of an assignee of the equity of redemption are concerned, the mortgaged premises are the primary fund for the payment of the debt, unless the mortgagor has conveyed to him with warranty; and the assignee may set up any defence which will be a bar to the [mortgagee's] claim against the land."

[10] [1936] 3 All E.R. 540.

[11] *Waring* v. *Ward* (1802) 7 Ves. 332 and *Mills* v. *United Counties Bank Ltd.* [1912] 1 Ch. 231, affirming [1911] 1 Ch. 669, were both cited.

[12] Gover, K.C.

in dismissing the claim to have the debt placed solely on the interest sold. Lord Wright M.R. stated that he did not think that that argument could "possibly succeed."[14] Romer L.J. stated that the proposed result would be "grossly inequitable."[15] He noted that the trustee's argument was based upon the proposition

> "that where a mortgagor mortgages his property to secure a loan to himself and subsequently assigns part of that property to a purchaser subject to the mortgage, there is an equity arising between him and the assignee under which the assignee becomes liable to indemnify the assignor against the whole of the mortgage debt."[16]

In response to this, he said

> "I venture to think that a more astonishing proposition than that was never advanced in a court of equity."[17]

The judgment of Lord Eldon in *Waring* v. *Ward*[18] referred only to a case where the whole of the mortgaged property was sold subject to the mortgage.

The Court of Appeal held that the equitable result was that the two properties, the policy and the settlement interest, should contribute rateably to the payment of the mortgage.[19]

8.3 The Nature of the Duty to Indemnify

It has been held that the purchaser need not enter into possession in order for the implied duty to take effect.[20] In *Mills* v. *United Counties Bank Ltd.*,[21] the plaintiff was entitled to a contingent

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[13] [1936] 3 All E.R. 540, 542.
[14] [1936] 3 All E.R. 540, 546.
[15] [1936] 3 All E.R. 540, 542.
[16] [1936] 3 All E.R. 540, 549.
[17] *Ibid.*
[18] (1802) 7 Ves. 332.
[19] In *In re Darby's Estate; Rendall* v. *Darby* [1907] 2 Ch. 465, it was held that where the mortgagor executed a voluntary conveyance of part of the mortgaged estate, after his death, his estate could not seek contribution to the payment of the mortgage from the voluntary grantee. In *Montreal Trust Co.* v. *Boggs* (1915) 25 D.L.R. 432, it was held that a transferee of an undivided share of mortgaged property was not obliged to indemnify the mortgagor/vendor. It is not clear whether or not the transfer was stated to have been made subject to the mortgage. Similarly, see *Dominion of Canada Investment & Debenture Co.* v. *Carstens* (1917) 36 D.L.R. 25 and *In re Macdonald* [1925] 2 D.L.R. 748, 750. However, in the last mentioned case, it was held that transferees of an undivided one-half interest in property, the transfer being expressed to be subject to a mortgage, were bound to indemnify the transferor/mortgagor. The court even stated, wrongly it is thought, that the effect of the transfer was to impose a personal obligation on the transferees to pay the mortgage debt. On the other hand, in *Ker* v. *Ker* (1869) I.R. 4 Eq. 15, it was held that where there was a paramount incumbrance over the property, a voluntary purchaser of a part was liable to contribute to the payment of the incumbrance.

reversionary interest in a piece of real estate. He had mortgaged this interest successively to (a) the defendant bank and (b) one Mobberley, his father-in-law. By a later agreement, the plaintiff assigned the equity of redemption of his interest absolutely to the bank. The bank's mortgage was kept alive solely for its protection against Mobberley's second mortgage. The bank covenanted to apply the proceeds of the property in the following order: (1) to its own mortgage; (2) to Mobberley's mortgage; (3) the residue to itself. The bank also covenanted to indemnify the plaintiff against liability for stamp duty.

Mobberley's successor to the second mortgage (the plaintiff's wife) later called on the plaintiff to pay the mortgage debt. The plaintiff thereupon brought this action. He claimed (a) a declaration that the bank should discharge and exonerate him from all liability in respect of his wife's claim; and (b) an order requiring the bank to pay the debt to his wife. The plaintiff based his claim on the purchaser's (the bank's) alleged implied covenant of indemnification.

At first instance, Eve J. dismissed the claim on two grounds. First, he held that the implied covenant of indemnification could only arise where the interest transferred had vested in possession. The interest here remained a contingent one. Secondly, the bank had in effect provided an express limited indemnity; it had undertaken to pay off the second mortgage, after it had satisfied its own mortgage. This express limited indemnity excluded the implication of a wider one. The Court of Appeal unanimously affirmed Eve J.'s decision on this second ground. All agreed that in the absence of an express stipulation, an implied duty to indemnify the transferor would be inferred. However, the express contractual provisions in the present case were inconsistent with any such implied duty. However, the judges expressed reservations about the first ground for Eve J.'s decision, without coming to a firm conclusion on the point. Farwell L.J. offered the opinion that the purchaser's duty to indemnify the vendor did not arise as a matter of implied contract. Rather, he said:

> "... it is and has always been treated as one of those equities, independent of contract, of which there are many examples in the books ... These equities still exist, although they are now sometimes erroneously called implied contracts ... Generally speaking, when A. sells and B. buys an equity of redemption, *i.e.* in other words property subject to a charge, it is against conscience and honesty for B. to set up that he has bought the property free from the charge at A.'s expense."

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[20] *Ashby* v. *Jenner* (1888) 32 S.J. 576. See also *Simpson* v. *Forrester* (1973) 132 C.L.R. 499, 517 *per* Gibbs J. In *Waring* v. *Ward* (1802) 7 Ves. 332, 337, Lord Eldon L.C. referred to a purchaser who was in possession and receipt of the "profits." A purchaser subject to a mortgage at an execution sale is no less under a duty to indemnify the vendor than any other purchaser: *Simpson* v. *Forrester* (1973) 132 C.L.R. 499, 509 (*per* Barwick C.J.), 516 (*per* Gibbs J.), disapproving of *Robertson* v. *Bank of Victoria* (1867) 4 W.W. & à B. (E.) 85.

[21] [1912] 1 Ch. 231, affirming [1911] 1 Ch. 669.

However, there was no place for this equity in view of the bank's express undertaking.

In other words, Farwell L.J. regarded the purchaser's obligation as being an equitable duty, "implied covenant" being only a metaphor. He appears to be referring to quasi-contractual or restitutionary obligations; it is noticeable that he refers to a case on contribution.[22] One may note here that many courts, particularly in the United States, have tended to regard the vendor as in a position analogous to a surety for the land in the hands of the purchaser, which is the primary fund for the payment of the debt, though it offends strict principle to describe one as a surety for a "fund."[23] The substance, of course, is that the vendor is ordinarily the only debtor, but with a right of indemnity over. It is also noteworthy that the principal debtor's implied duty to indemnify the surety has sometimes been held to have been excluded if he undertook expressly to indemnify him.[24]

8.3.a The Extent of the Duty to Indemnify

It is important to draw a distinction between an undertaking by the purchaser to pay off incumbrances on the estate, and a mere duty on him to indemnify his vendor. In the former case, the purchaser will be liable to the full value of the claims secured by the incumbrances. Also, some jurisdictions will recognise the rights of the creditors directly to enforce the purchaser's undertaking.[25]

On the other hand, where the purchaser is merely bound to indemnify his vendor, his liability will only accrue as and so far as the vendor is pursued by the creditors. He cannot be personally liable to

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[22] *Stirling* v. *Forrester* (1821) 3 Bli. 575, 590 *per* Lord Redesdale, on which, see *ante.* In *Simpson* v. *Forrester* (1973) 132 C.L.R. 499, Gibbs J. agreed with Farwell L.J.'s view, denying that the right to an indemnity arose from contract. He derived support for this view from *In re Mainwaring's Settlement Trusts, Mainwaring's Trustee in Bankruptcy* v. *Verden* [1937] Ch. 96, where the right to indemnification (or contribution, in that case) was held to arise even though the transfer was a voluntary one. Gibbs J. said that it would be "against conscience and honesty" for a purchaser at a sheriff's sale who had purchased on the footing that the property was subject to a mortgage afterwards to assert that he had bought it free from the mortgage, and to try to cast the burden of the mortgage onto the vendor-mortgagor. *Cf. Guaranty Trust Company of Canada* v. *Bailey* (1985) 18 D.L.R. (4th) 576, 584-5, where the court stated that

> "Somewhere behind the rule expressed by Lord Eldon is what is more recently has been called unjust enrichment. It may be that the current registered owner (whether he obtained title by mortgage or transfer) is unjustly enriched if an incumbrance on his title is discharged because some stranger (in contractual terms, for example, the original mortgagor) is called upon by the mortgagee to perform his personal obligation to pay."

In that case, the court thought that in previous cases, the right had not been held to have arisen in the absence of a contractual relationship. In any event, it could not have arisen on the facts of that case: a junior mortgagee foreclosed his mortgage, and then transferred his interest. It was held that there was no reason why the transferee should have to indemnify the mortgagee-transferor, who was not liable to pay the prior mortgage.

[23] *Murray* v. *Marshall*, 94 N.Y. 611 (1884); *Shepherd* v. *May*, 115 U.S. 505 (1885).

[24] See section 1.3 and 7.13.a, *ante*.

the creditors. Further, and crucially, it is felt, his liability to the vendor cannot exceed the value of the land. If the creditors' claims prove to exceed the value of the land, he ought to be able to return the land to the vendor or hand it over to the creditors, and walk away with no further liability.[26]

A transaction in which the purchaser bought a property subject to incumbrances, and thereby incurred liabilities which exceeded the value of what he has bought would be irrational. It could not have been the intention of the purchaser to take a needless risk that he will end up with an asset which is of negative worth to him. Further, if his liability extended beyond the value of the land, the effect of buying land, assuming the payment of incumbrances on it, would be the same as buying without assuming the payment of incumbrances. It is felt that this would be contrary to precedent and to sense. The issue seems seldom to have arisen for decision because it would be unusual for a purchaser to buy, for whatever price, a piece of valueless property.[27] However, it may occur that the value of the land will fall after the purchase, thereby leaving unsatisfied creditors. This was the case in *Adair* v. *Carden*.[28]

The mortgagor had conveyed lands subject to a mortgage, on the condition that the lands so conveyed should be "primarily liable" for the mortgage debt, and should exonerate other lands held by the mortgagor which were also subject to the same mortgage. Under the agreement to sell, the purchaser was

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[25] See section 8.4 and notes thereto, *post.*

[26] *Cf. Ashby* v. *Jenner* (1888) 32 S.J. 576.

[27] There has been comparatively little authority on the pecuniary extent of the purchaser's implied duty to indemnify the vendor. E.A. Farnsworth, *Farnsworth on Contracts* (1990), III, § 10.5a, assumes that the purchaser cannot be liable beyond the value of the lands: "Since [the purchaser] is under no duty to pay the loan, if there is a default on the loan and the price of the land has plummeted ... only [the mortgagor], not [the purchaser], is liable for the ... deficiency. Thus, by letting Mortgagee foreclose, the non-assuming grantee can cut its losses to the [sum] it paid [to the vendor]." In *Tichenor* v. *Dodd*, 4 N.J. Eq. 454 (Ch. 1844), it was stated that "The purchaser of a mere equity of redemption purchases a right, and does not assume an obligation to redeem, and may at his pleasure give up the mortgaged premises in satisfaction of the incumbrance. He is liable to the extent of the value of the premises and not beyond it." However, in that case, the purchaser had in fact undertaken to pay the mortgage, so the passage above quoted was *obiter*. In *Reeves* v. *Cordes*, 108 N.J. Eq. 469; 155 A. 547 (Ch. 1931), Lewis V.-C. stated, referring, *inter alia*, to *Waring* v. *Ward* (1802) 7 Ves. 332, that "the liability of a grantee of a mere equity of redemption is limited to, and does not extend beyond, the value of the property so acquired, and which he may at his pleasure, give up in satisfaction of the incumbrance thereon, thereby completely exonerating himself" (quoted from Lexis transcript at page *12). This meant that if the mortgagee extended the time for payment by the purchaser, the mortgagor would only be discharged to the value of the property at the time originally fixed for payment by the mortgage. See also *Friedman* v. *Zuckerman*, 104 N.J. Eq. 322; 145 A. 541 (Ch. 1929), where it was held that a purchaser who did not assume the payment of the mortgage debt was not liable to the *mortgagee* for any deficiency in the value of the land. In *Schmucker* v. *Sibert*, 18 Kans. 104; 26 Am. Rep. 765 (1877), Brewer J. said: "... it would seem to be clear, that where the deed specifies that it is made subject to a certain mortgage, an acceptance of a deed is an undertaking that to the extent at least of the value of the granted premises the grantee shall pay the mortgage. Or, in other words, it is an agreement by the grantee that the granted premises shall be used so far as may be necessary to discharge and pay the mortgage." It seems to be implied by these words that the purchaser's obligation does not extend beyond the value of the land, though it is perhaps not an unequivocal assertion.

[28] (1892) 29 L.R. Ir. 469. See "*Obiter Dicta*," (1893) 27 I.L.T.S.J. 29.

given credit for the amount of the mortgage against the purchase price for the land, and paid only the balance in cash.

The purchaser fell into arrears with the payment of interest on the mortgage. In order to prevent the mortgagee from selling the portion of the estate retained by the mortgagor, the mortgagor himself paid the arrears of interest. The mortgagee then appointed a receiver over the portion of the estate which had been sold to the purchaser. However, this portion proved to be a deficient security. The mortgagee therefore threatened legal proceedings against the mortgagor, who remained personally liable for the debt.

The mortgagor had died before these proceedings were brought. His executrix now claimed that his estate was entitled to be indemnified by the purchaser against all claims by the mortgagee, or in any event to the extent of the sums of interest which the purchaser had failed to pay. This was notwithstanding the deficiency of the value of the property sold.

Counsel for the vendor[29] relied on the implied "covenant" of indemnity described in *Waring* v. *Ward*.[30] They also referred to what was described as the "implied covenant" by which successive assignees of a lease were obliged to indemnify the original lessee against breaches of the lease committed while the assignee was in possession.[31] In other words, the foundation of their claim was that the mortgagor's estate had a quasi-contractual right to be indemnified by the purchaser.[32]

Counsel for the purchaser accepted that the lands were liable to be sold, but denied any personal liability of the purchaser to the mortgagor beyond the value of the lands. Porter M.R. stated that the extent of the "covenant" to indemnify had not been decided in previous cases. The comments of Lord Eldon in *Waring* v. *Ward* were general in terms, and contained no indication that the covenant was limited in amount to the value of the lands. Porter M.R. conceded that the purchaser's personal estate would not be liable to bear the burden of the debt, as against the property itself in his hands. However, he did not regard this as being material to a consideration of the purchaser's duty to indemnify the mortgagor.[33]

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[29] Walker, Q.C., Kenny, Q.C., and Matheson.
[30] (1802) 7 Ves. 332.
[31] See chapter 9, *post*.
[32] Counsel stated (at 473):

> "The basis of liability in the case of the purchaser of an estate subject to mortgages and of the assignee of a lease is the same, viz., that they both take their estates subject to certain duties and liabilities or incumbrances as the case may be. They respectively take over a particular thing with obligations affecting it."

[33] This is correct in principle, but seems to be gainsaid by the judge's ultimate conclusion.

The outcome of the case was that the purchaser was required to indemnify the mortgagor's estate up to the full amount of the mortgage. The only distinction between this result and a finding that the purchaser was liable to pay the mortgage debt (which Porter M.R. admitted was not the case) seems to be that the purchaser was liable to pay the vendor's estate as the instalments fall due, rather than the mortgagee himself. It is felt that Porter M.R.'s decision contradicts the body of case law dealing with the circumstances in which the purchaser becomes personally liable for the mortgage debt.[34]

In *Simpson* v. *Forrester*,[35] a mortgagee of a leasehold interest had caused the mortgagor's equity of redemption to be sold by the sheriff at an execution sale. The mortgagee bought the equity of redemption. The court were agreed that the effect of the purchase had been to extinguish the mortgage. They also agreed that the mortgagee, as purchaser, was bound to indemnify the mortgagor against the mortgage debt. However, the majority of the court held that the sale price of the equity of redemption had to be credited against the amount due on the mortgage. Therefore, the mortgagee-purchaser was only bound to indemnify the mortgagor to the amount of the mortgage so reduced by the sale price. The effect was that the mortgagee would make a profit, effectively equal to the sale price of the equity of redemption. It was conceded by the mortgagee that the sale may have been conducted in a misleading manner, as the sheriff had not explained that the sale price would be used to reduce the mortgage on the property, and thereby increase the value of the equity of redemption. The majority therefore put the mortgagor to his election, whether he wished to affirm the sale or have it set aside.

Barwick C.J. dissented, holding that the mortgagee-purchaser was bound to indemnify the mortgagor for the full amount of the mortgage debt. He held that, as the effect of the purchase was to effect the extinction of the mortgage, the mortgagee would be accountable to the mortgagor for the sale price of the equity of redemption which he received.[36] The result of Barwick C.J.'s approach seems preferable. Logically, the result should have been the same even if the purchaser had not been the mortgagee.[37]

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[34] *Parsons* v. *Freeman* (1751) Ambler 115; *Tweddell* v. *Tweddell* (1786) 2 Bro. Ch. C. 101; 152; *Woods* v. *Huntingford* (1796) 3 Ves. 128; *Butler* v. *Butler* (1800) 5 Ves. 534; *Waring* v. *Ward* (1802) 7 Ves. 332; *Barry* v. *Harding* (1844) 1 J. & La T. 475, 486-7. *Rochfort* v. *Earl of Belvedere* (1772) 6 Bro. P.C. 520, affirming (1770) Wall. Lyne 45; Finlay, *Digest*, 5n is to the contrary, but, judging from the later cases, seems to have been wrongly decided. One should also note the opinion of Pearson J. in *Syer* v. *Gladstone* (1885) 30 Ch. D. 614, that Locke King's Acts (Real Estate Charges Act 1854 (17 & 18 Vict., c. 113); Real Estate Charges (Amendment) Act 1867 (30 & 31 Vict., c. 69); Real Estate Charges (Amendment) Act 1877 (40 & 41 Vict., c. 34)) imposed no personal liability on a devisee of incumbered land to indemnify the personal estate for the balance of a mortgage debt if the devised estate was deficient.

[35] (1973) 132 C.L.R. 499.

[36] (1973) 132 C.L.R. 499, 510. The case was treated as being similar to a realisation of a surplus on the security.

[37] Otherwise, the purchaser would receive a windfall, as his incumbered property would have its incumbrances reduced by an amount equal to the sum which he paid for it *as* incumbered property. *Cf. Cox* v. *Wheeler*, 7 Paige Ch. 248 (N.Y. 1838), discussed *post*. In *Gordon Grant and Co. Ltd.* v. *F.L. Boos* [1926] A.C. 781, a second mortgagee had brought proceedings for the sale of the mortgagor's interest,

8.4 The Incumbrancer's Rights against a Purchaser who assumed the payment of the Incumbrance

Where the purchaser had promised the vendor to pay a mortgage or other incumbrance on the property, difficulties existed at common law for the incumbrancer (usually a mortgagee) in enforcing that promise. The general rule of privity of contract militated against the recognition of the mortgagee's right to enforce that promise as one which was made for his benefit.[38] The mortgagee was occasionally granted rights on the basis of other theories, for instance under an exception to the general rule of privity of contract,[39] or on the theory that a creditor was entitled to enforce for his own benefit a covenant of

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subject to the first mortgage. With leave of the court, the second mortgagee bought the said interest at the sale, for a very low price. The second mortgagee then sold the interest which it had to a third party for a much higher price. The second mortgagee then sued the mortgagor for the balance of the mortgage debt, after deduction of the sum which *it had paid* for the property. The Privy Council held that it was so entitled. The sale was evidently not made subject to the second mortgage. If it had been, the second mortgagee as purchaser would have been bound to indemnify the mortgagor, and thus could not have claimed payment from the mortgagor. It does not appear whether there was any covenant by the mortgagor against incumbrances other than the first mortgage. It seems to have been taken for granted that there was.

[38] *In re The Law Courts Chambers Co. Ltd.* (1890) 61 L.T. (n.s.) 669, 671 *per* Stirling J.; *Forster* v. *Ivey* (1901) 2 O.L.R. 480, 483; *Simpson* v. *Forrester* (1973) 132 C.L.R. 499, 518 *per* Gibbs J. Even where the purchaser had made payments of interest to the mortgagee, this was held not to render him directly liable for the mortgage debt to the mortgagee. In one such case, *In re Errington, Ex parte Mason* [1894] 1 Q.B. 11, the judge rationalised the payments of interest as "a perfectly natural act" done to preserve the property from foreclosure. There could not have been a novation, as there had not been the usual consideration for one, namely the discharge of the original mortgagor. One may contrast a decision from Ontario, *In re Cozier; Parker* v. *Glover* (1877) 24 Grant (Ont.) 537, in which the purchaser had covenanted with the mortgagor to pay the mortgage, and subsequently made payments in respect thereof to the mortgagee. It was held that this was enough to imply an agreement by the purchaser to hold the value of the incumbrance (as part of the purchase price) to the mortgagee's use. The mortgagee could prove for this amount against the purchaser's estate, as he could have sued him for it at law. This is contrary to the position stated in the text. In *Maloney* v. *Campbell* (1897) 28 S.C.R. 228, the mortgagor had assigned the purchaser's covenant to pay the debt to the mortgagee, who was held to be entitled to enforce it against the purchaser (although the court treated the covenant as merely one to indemnify the mortgagor).

It is notable, however, that there are some early judicial statements favouring the view that a mortgagee should be entitled to enforce the purchaser's promise to the mortgagor: *Parsons* v. *Freeman* (1751) Ambler 115; *Rochfort* v. *The Earl of Belvidere* (1770) Wall. Lyne 45; Finlay, *Digest*, 5n., affirmed at (1772) 6 Bro. P.C. 520, at Finlay, *Digest*, 5n., 8n.; *The Duke of Cumberland* v. *Codrington*, 3 Johns. Ch. 229, 254 (N.Y. 1817).

[39] Aside from the early cases mentioned in the preceding note, this theory has found some application in the United States: *Thorp* v. *Keokuk Coal Company of the City of New York*, 48 N.Y. 253 (1872); *Campbell* v. *Smith*, 71 N.Y. 26 (1877), applying the doctrine laid down in *Lawrence* v. *Fox*, 20 N.Y. 268 (1859). One may contrast other American decisions, however, which denied relief to the mortgagee. In *King* v. *Whitely*, 10 Paige Ch. 465 (N.Y. 1843), Walworth C. held that a covenant by which the purchaser assumed the payment of a mortgage debt was in substance only a covenant of indemnity with the vendor, and was not a promise of payment for the benefit of the mortgagee. In that case, however, the vendor had not himself been liable to the mortgagee, which no doubt influenced the finding. The decision was purportedly overruled in *Thorp*, but received the approval of the Supreme Court of the United States in *Keller* v. *Ashford*, 133 U.S. 610, 623; 10 S.Ct. 494, 497; 33 L. Ed. 667 (1890). Note also *Aetna National*

indemnification given by the principal debtor (the vendor) to the surety (purchaser).[40] It is also possible for a novation to occur, provided that the mortgagee is a party and agrees to accept the purchaser as debtor in place of the mortgagor.[41] Statute in England now appears to offer recourse to the mortgagee if the deed of conveyance between vendor and purchaser contains a covenant by the purchaser to pay the debt which is expressed to have been made with the mortgagee, even though the latter is not a party to the deed.[42] Where the covenant is not stated so to have been made, it seems that the mortgagee's position will remain problematic.[43]

8.5 The Mortgagor's Right of Subrogation where the Purchaser did not assume the payment of the mortgage debt

It has been seen that it is normally held that, after a conveyance subject to the mortgage, the land is the primary fund for the payment of the debt. Where the mortgagor is then compelled to pay the mortgage debt, he is normally held to have been subrogated to the mortgagee's rights under the mortgage

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Bank v. *Fourth National Bank of the City of New York*, 46 N.Y. 82, 89-90; 7 Am. Rep. 314, 320 (1871), where it was stated that this doctrine was only applicable where there had been some trust or the defendant had been charged for money which *ex aequo et bono* belonged to the plaintiff. See also *Garnsey* v. *Rogers*, 47 N.Y. 233; 7 Am. Rep. 440 (1872), *Vrooman* v. *Turner*, 69 N.Y. 280; 25 Am. Rep. 195 (1877) and *Ayers* v. *Dixon*, 78 N.Y. 318, 323 (1879). The theory was rejected in *Keller* v. *Ashford*, 133 U.S. 610, 625; 10 S.Ct. 494, 498; 33 L. Ed. 667 (1890) and *Tamiami Investment Co.* v. *Berk*, 57 F. 2d 1034 (C.A. 3rd 1932). However, its acceptance in New York and Illinois was recognised in *Union Mutual Life Insurance Co.* v. *Hanford*, 143 U.S. 187, 189; 12 S.Ct. 437; 36 L. Ed. 118 (1892). In *New York Life Insurance Co.* v. *Aitkin*, 125 N.Y. 660; 26 N.E. 732 (1891), it was held that the grantor could not release the grantee who had assumed the payment of the mortgage after the mortgagee had obtained judgment for foreclosure, naming the grantee as a party.

[40] This was a specious doctrine which has been discredited in England: *In re Walker; Sheffield Banking Co.* v. *Clayton* [1892] 1 Ch. 621. American courts often held that the mortgagee was entitled to obtain the benefit of the purchaser's covenant to pay the mortgage, as a "collateral benefit" held by the mortgagor, who was in a situation similar to that of a surety: see *Moses* v. *Murgatroyd*, 1 Johns. Ch. 119 (N.Y. 1814); *Phillips* v. *Thompson*, 2 Johns. Ch. 418 (N.Y. 1817); *King* v. *Harman's Heirs*, 6 La. 607; 26 Am. Dec. 485 (1834); *Curtis* v. *Tyler*, 9 Paige Ch. 432, 435 (N.Y. 1842); *King* v. *Whitely*, 10 Paige Ch. 465 (N.Y. 1843); *New London Bank* v. *Lee*, 11 Conn. 112; 27 Am. Dec. 713 (1835) and note thereto; *Clark* v. *Ely*, 2 Sandf. Ch. 166 (N.Y. 1845); *Garnsey* v. *Rogers*, 47 N.Y. 233, 236; 7 Am. Rep. 440 (1872); *Osborne* v. *Cabell*, 77 Va. 462 (1883); *Biddel* v. *Brizzolara*, 64 Cal. 354, 361-2; 30 P. 609, 612 (1883); *Dille* v. *Hammond*, 59 F. 2d 1048; 61 App. D.C. 234 (1932). In *Keller* v. *Ashford*, 133 U.S. 610, 623; 10 S.Ct. 494, 497; 33 L. Ed. 667 (1890), the court stated that the doctrine was applicable though the purchaser, as notional principal debtor, had never been personally liable to the creditor. Similarly, *Ward* v. *De Oca*, 120 Cal. 102, 105; 52 P. 130 (1898). In *Crowell* v. *Hospital of St. Barnabas*, 27 N.J. Eq. 650, 655-6 (E. & A. 1876) (affirming *Crowell* v. *Currier*, 27 N.J. Eq. 152 (Ch. 1876)), Depue J. justified this result as avoiding circuity of action and the harassment of the mortgagor, who was effectively a surety.

[41] For the necessary requirements, see *National Trust Co.* v. *Mead* (1990) 71 D.L.R. (4th) 488; *In re Prospect Mortgage Investment Corporation and Van-5 Developments Ltd.* (1985) 23 D.L.R. (4th) 349.

[42] Law of Property Act 1925, section 56(1). The effect is similar to the insertion of a covenant for the benefit of the mortgagee in a deed poll, which is regarded as a contract made with the world at large, enforceable by any party for whose benefit a provision is included. See, *e.g.*, *Poe* v. *Dixon*, 60 Ohio St. 124, 132-3; 54 N.E. 86, 88 (1899).

[43] See *Emmet on Title*, § 17.003.

against the land.[44] In order to give effect to that right, the mortgagor has been held entitled to an assignment of the bond and mortgage for his benefit.

In *Murray* v. *Marshall*,[45] Finch J. noted that on sale subject to a mortgage, the land became the primary fund for payment of the debt. It could therefore be said that the mortgagor stood in a position analogous to that of a surety to the conveyed land:[46]

> "This follows inevitably from the right of subrogation which inheres in the original contract of sale and conveyance. It is a definite and recognized right, which, in the absence of an express agreement, will be founded upon one implied.[47] When the mortgagor in this case sold expressly subject to the mortgage, remaining liable upon his bond, he had a right as against his grantee to require that the land should first be exhausted in the payment of the debt ... Seller and buyer both acted upon the understanding that the land bound for the debt should pay the debt as far as it would go, and their contract necessarily implied that agreement. Through the right of subrogation the vendor could secure his safety, and that right could not be invaded with impunity."[48]

In *Cox* v. *Wheeler*,[49] Walworth C. held that if land was sold subject to a mortgage, the effect was to render the land the primary fund for the payment of the mortgage debt in equity. He stated that

> "if the premises were sold to a stranger, the mortgagor, upon being compelled to pay the incumbrance by suit upon the bond, would be entitled to be substituted in the place of the holder of the incumbrance as to the remedy against the land as the primary debtor."[50]

In *Brewer* v. *Staples*,[51] S., the mortgagor of land, had assigned, as security, a mortgage which he held on Q.'s land to a trustee for B., his own mortgagee. S. later sold the land subject to B.'s mortgage to the T. Co., in settlement of a debt which he owed it. The value of the land after deducting B.'s incumbrance was less than the value of this debt. B. then filed a bill to foreclose, to which the T. Co. made a reply. In its reply, the T. Co. claimed to be entitled to either of two alternate forms of relief:

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[44] *Johnson* v. *Zink*, 51 N.Y. 333, 336 (1873).
[45] 94 N.Y. 611 (1884).
[46] Though he clearly accepted that the mortgagor could not be said strictly to be a surety, as the purchaser had not made himself personally liable for the debt: 94 N.Y. 611, 615 (1884).
[47] Referring to *Gans* v. *Thieme*, 93 N.Y. 225, 232 (1883).
[48] 94 N.Y. 611, 615 (1884), quoted with approval in *White* v. *Augello*, 142 Misc. 233, 238; 254 N.Y.S. 228 (1931).
[49] 7 Paige Ch. 248 (N.Y. 1838).
[50] 7 Paige Ch. 248, 258 (N.Y. 1838).
[51] 3 Sandf. Ch. 579 (3rd ed., 631) (N.Y. 1846).

(i) an order for foreclosure of the "Q. mortgage," the sum realised on the sale of those premises to be credited against S.'s debt to B., or

(ii) an order that that B. was obliged to resort first to the Q. fund, so as to preserve as best as might be the interest of the T. Co.[52]

Finally, if the premises were to be sold, the T. Co. claimed to be subrogated to the mortgage on Q.'s land, upon payment of S.'s debt.

Sandford V.-C. rejected all of the T. Co.'s claims. He held that when S. had transferred the land to the T. Co., subject to the mortgage, he had not transferred any interest in the Q. mortgage. The consequence of the conveyance in settlement of the debt was that the T. Co. had ceased to be creditors of S., and had instead become purchasers of the land, subject to the mortgage to B. The "clear effect" of this was that as between S. and the conveyed land, S. became a surety for the latter. While the T. Co. did not become personally liable to pay the debts, the lands in their hands became the primary fund for payment of those debts. The case was indistinguishable from *Jumel* v. *Jumel*,[53] *Cox* v. *Wheeler*,[54] or *Tice* v. *Annin*.[55]

He also held that the T. Co. was not entitled to have the securities marshalled in its favour. This was because marshalling of securities could only be available to a creditor where another creditor had a claim in respect of two funds for the same debt. Here, the T. Co. was no longer a debtor of S., as it had accepted a conveyance of incumbered land from him in settlement of its debt.[56] The Vice-Chancellor also held that the T. Co. had no right to compel the Q. mortgage to be credited against S.'s debt to B. Rather, S. himself had an equity to force the sale of the property he had conveyed to the T. Co., in order to pay his debt to B., so that the Q. mortgage, which he had assigned to B. as security, might be returned to him.

Dixon argued against the entitlement of the vendor to subrogation, on the ground that, unless he took security from the purchaser, his right to indemnity was merely equitable, and did not entitle him to an assignment of a mortgage which he had created.[57] Dixon interpreted the vendor's supposed right to be one to demand an assignment of the mortgage, which would normally include the legal estate. This would

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[52] In other words, this was a claim to have B.'s securities marshalled.
[53] 7 Paige Ch. 591 (N.Y. 1839).
[54] 7 Paige Ch. 248 (N.Y. 1838).
[55] 2 Johns. Ch. 125 (N.Y. 1816).
[56] In order for a creditor to be entitled to marshal securities against another creditor, it is essential that each should have a claim against a common debtor: Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992) § 1108.
[57] *Op. cit.*, 86-8.

be enforceable against *bona fide* sub-purchasers from the purchaser without notice of the vendor's claim, and he regarded this outcome as unfair.[58]

8.7 The Mortgagor's Right of Subrogation where the Purchaser undertook to pay the Mortgage Debt

Where a purchaser covenants or promises orally to pay a mortgage secured on land which he purchases, the vendor may recover from him in an action at law on the promise to the extent that he is damnified by the purchaser's failure to perform his promise.[59] As in the last case, it is sometimes said that the land is the primary fund for payment of the debt,[60] though this is misleading, as the purchaser is *ex hypothesi* personally liable to the mortgagor, and, as has been seen in a previous section, there may be exceptions to the general rule that the estate charged is the proper fund for the payment of the debt. There are some English *dicta* of note. In *Butler* v. *Butler*,[61] Sir Richard Pepper Arden M.R. stated that if the mortgagor had been sued by the mortgagee, the mortgagor "might have compelled [the purchaser] in his life-time to indemnify him."[62] He continued, however, that he believed that "the decree would have been for a sale of the estate, and not for payment out of his personal estate."[63] If, however, the purchaser had disposed of his real estate somehow, his personal estate would have been liable, rather than the real estate in the hands of a third party. The mortgagor may pay the debt at any time after it becomes due, without waiting to be pursued for payment, and may thereafter claim indemnification from the purchaser.[64]

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[58] *Op. cit.*, 87. If the vendor had obtained the legal title, presumably Dixon would have agreed that this should prevail even against *bona fide* sub-purchasers, whose interests could only be equitable.

[59] In *Halsey* v. *Reed*, 9 Paige Ch. 446, 452 (N.Y. 1842), Walworth C. held that the mortgagor could only recover from the purchaser on the latter's covenant to pay the mortgage debt the amount which the mortgagor had been forced to pay the mortgagee. Also, *Ayers* v. *Dixon*, 78 N.Y. 318 (1879). In *Comstock* v. *Drohan*, 71 N.Y. 9 (1877), it was held that the mortgagor could also recover from the purchaser the costs which he had been forced to pay the mortgagee in foreclosure proceedings by the latter. As has been seen, a surety is normally entitled to reimbursement from the principal debtor of the amount of costs which he had to pay to the creditor. See also *Bolles* v. *Beach*, 22 N.J.L. 680; 53 Am. Dec. 263 (1850). In those American jurisdictions which permit an action to be brought by a third party to a promise which was made for his benefit, a mortgagor may be permitted to sue a subsequent purchaser from the initial purchaser, if the subsequent purchaser promised to pay off the mortgage debt: *Evans* v. *Sperry*, 12 F. 2d 438 (E.D. Ill. 1926).

[60] *Comstock* v. *Drohan*, 71 N.Y. 9, 13 (1877).

[61] (1800) 5 Ves. 534.

[62] (1800) 5 Ves. 534, 538. The mortgagor has the same anticipatory right to exoneration as the surety: *Marsh* v. *Pike*, 10 Paige Ch. 595 (N.Y. 1844); *Marshall* v. *Davies*, 78 N.Y. 414, 421 (1879). As in the case of the surety, the mortgagor cannot compel the mortgagee to pursue the purchaser: *Marsh* v. *Pike*, 10 Paige Ch. 595, 597 (N.Y. 1844); *Fish* v. *Glover*, 154 Ill. 86, 93; 39 N.E. 1081, 1083 (1894). However, it was suggested in one New York case (where, arguably, the law of New Jersey applied), that a purchaser who had assumed the payment of the mortgage debt, but then sold the property on, the subsequent purchaser also assuming the payment of the debt, was entitled to have the lands sold before resort could be had to him: *New York Life Insurance Co.* v. *Aitkin*, 125 N.Y. 660, 675; 26 N.E. 732, 736 (1891).

[63] *Ibid.*

[64] *Devenish* v. *Connacher* [1930] 3 D.L.R. 977. In *Poe* v. *Dixon*, 60 Ohio St. 124; 54 N.E. 86 (1899), it was held that, as in the case of principal and surety (see *ante*), the mortgagor-grantor's right of

Where there are a succession of purchasers, each of whom agrees to pay the mortgage debt, it has been held in at least one American case that the initial mortgagor may claim against each for his indemnification, and that, to avoid circuity, the court will grant judgment against the last purchaser.[65] Given that there is no privity of contract between the mortgagor and a subsequent purchaser, the outcome was explained on the ground that the mortgagor was subrogated to his purchaser's rights against a later purchaser, and so on.[66] This was an application of the supposed entitlement of a creditor to be subrogated to a surety's rights against the principal debtor. It does not appear that such an outcome could be attained in Ireland. Statute might permit it in England and Wales.[67]

In *Palmer* v. *Hendrie*,[68] a mortgagor had transferred leasehold property subject to the mortgage. The purchaser covenanted to pay the mortgage debt and to indemnify the mortgagor. At a later time, the purchaser and mortgagee joined in the granting of under-leases at a nominal rent. The purchaser received valuable consideration for these, but the mortgagee did not. The purchaser later absconded and was declared bankrupt. The mortgagee claimed the balance due on the mortgage from the mortgagor, who n turn claimed that he had been discharged from liability by the granting of the under-leases.[69]

Sir John Romilly M.R. observed that a mortgagee, when he was paid in full by a mortgagor, was obliged to deliver the mortgaged estate to him.[70] It followed from this that where the mortgagee had

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indemnification from the purchaser arose at the time of the purchase (*i.e.*, at the time when the relation analogous to principal and surety arose between them). However, the mortgagor-grantor's right to sue for indemnification arose at the time of payment to the mortgagee (60 Ohio St. 124, 135; 54 N.E. 86, 89 (1899)).

[65] *Osborne* v. *Cabell*, 77 Va. 462 (1883).

[66] 77 Va. 462, 467 (1883).

[67] Law of Property Act 1925, section 56(1). However, on the strength of *R.P.H. Ltd.* v. *Mirror Group (Holdings) Ltd.* (1993) 65 P. & C.R. 252, it seems unlikely. In that case, an original tenant attempted to compel its immediate assignee to enforce a covenant for indemnification from a second assignee. It was held that the original tenant had no such right.

[68] (1859) 27 Beav. 349; (1860) 28 Beav. 341.

[69] One of the grounds unsuccessfully advanced was that, after the transfer, the mortgagor was merely a surety, and the mortgagee's subsequent action in granting the under-leases had discharged him. Sir John Romilly M.R. did not regard the case as depending on the rules of suretyship, but the view he took seems comparable to an application of those rules. See also *Walker* v. *Jones* (1866) L.R. 1 P.C. 50, 62 *per* Turner L.J.

[70] In *Lockhart* v. *Hardy* (1846) 9 Beav. 349, a mortgagee demanded a deficiency of the mortgage debt from the mortgagor after foreclosing the mortgagor's equity of redemption of the mortgaged premises. It was held that subsequent payment by the mortgagor would "open" the foreclosure and entitle the mortgagor to a re-conveyance of the estate. Where this was no longer possible, as where the mortgagee had conveyed to a third party, the mortgagor would be discharged from his personal liability.

In the later case of *Walker* v. *Jones* (1866) L.R. 1 P.C. 50, a mortgagor had given a mortgage and promissory notes to the mortgagee, and the latter had assigned the mortgage and indorsed the notes to a transferee (a discounter). The transferee later re-conveyed to the mortgagee, when the latter paid him. However, the transferee retained the notes, and now brought an action on them against the mortgagor. It was held that the mortgagor was entitled to an injunction restraining the bringing of the action. The

rendered it impossible to return the estate to the mortgagor, the latter was discharged from further personal liability for the debt. The fact that the mortgagor had conveyed the equity of redemption did not affect his entitlement to have the estate returned to him on paying the debt. The purchasers had covenanted to pay the debt and indemnify the mortgagor. This lent weight to the entitlement of the mortgagor. Since the mortgagee had rendered it impossible to return the estate to the mortgagor, the latter was discharged.

The case can be understood as an analogy to cases of discharge of a surety by the disposal of a security by the creditor. In this case, the purchaser was the primarily liable party. The mortgagor was secondarily liable. The creditor had disposed of rights to which the mortgagor would have been subrogated if he had paid the debt. The effect of this was to discharge the mortgagor from liability.

In *Kinnaird* v. *Trollope*,[71] the mortgagor had mortgaged land for £12,000. He later transferred the land to a purchaser, subject to the mortgage. The purchaser covenanted to pay the debt and to indemnify the mortgagor. The purchaser later charged the premises to the same mortgagee for a further £8,000. He covenanted that the premises should not be redeemed save on payment of the £8,000 as well as the £12,000. The purchaser later became insolvent. The mortgagee then sought payment of the £12,000 from the mortgagor. The mortgagor refused to do this except upon the terms that the mortgagee should assign the mortgage to him, so that he could secure the £12,000 as having a first charge on the land.

The mortgagee refused to accept these terms, and brought an action against the mortgagor on his covenant to pay the £12,000. A special case was stated for the court's opinion on the question of whether or not the mortgagee was entitled to judgment, and if so, upon what terms. The mortgagor accepted that the purchaser of the estate subject to the mortgage was free to charge it again. However, where the mortgagee sued the original mortgagor on his covenant,

> "he [called] into life rights which did not previously exist; and the original mortgagor can claim to hold the estate in effect as first mortgagee to the extent of the sum which he is called upon to pay under his covenant."

This is in effect a claim that if the mortgagor paid the £12,000, he was entitled to be subrogated to the mortgagee's rights for that amount. The mortgagor argued that judgment should only be given on the terms that the mortgagee thereupon re-convey the mortgage to secure the £12,000 to the mortgagor.

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transferee of the mortgage owed the same duties to the mortgagor as did the mortgagee. In this case, the transferee had made it impossible for the mortgagor to obtain a re-conveyance on payment of the debt, because he had severed the notes from the security. Therefore, the mortgagor had been discharged. *Cf.* *Rudge* v. *Richens* (1873) L.R. 8 C.P. 358, where it was held that a mortgagor had not been discharged from liability by a sale by a mortgagee under a power to that effect in the mortgage deed.

Stirling J. adopted this view. He noted that a mortgagor was entitled to a re-conveyance of the property on payment of the mortgage debt.[72] This duty continued to apply to the situation where the mortgagor had parted with his interest in the property, but remained liable to the mortgagee. If he paid the mortgagee, he would still be entitled to a re-conveyance of the mortgage interest.[73] In that sense, mortgagor and mortgagee were under reciprocal obligations. Thus, the mortgagor's covenant to pay the debt was conditional upon the mortgagee's ability to restore the mortgage interest to him upon receipt of payment.[74] Where the mortgagor had parted with the equity of redemption, he nonetheless acquired a new right to redeem if he was sued by the mortgagee. Upon redeeming, he would be entitled to a re-conveyance subject to such equity of redemption as might be vested in any other person. In other words, the purchaser from the mortgagor would himself remain entitled to redeem *from the mortgagor*.

The fact that the purchaser from the mortgagor had mortgaged again, whether to the original mortgagee, or to a new one, did not affect the mortgagor's rights. *Palmer* v. *Hendrie*[75] showed that, on payment, the mortgagor was entitled to have the mortgage interest returned to him unimpeded by any acts by the mortgagee which were unauthorised by the mortgagor. While such authorisation could be inferred either from a power granted in the deed[76] or from the mortgagor's direct concurrence, the mere concurrence of the purchaser of the equity of redemption in the mortgagee's acts was insufficient. The mortgagor could not, therefore, be regarded as being bound by the second mortgage, and was entitled to stand as prior incumbrancer for the first £12,000.

In the American case of *Marsh* v. *Pike*,[77] the complainant, Marsh, had mortgaged property to Pike, and then conveyed the property to McLean, subject to the mortgage. McLean agreed to pay off and discharge the mortgage, the amount of which was deducted from the purchase price. McLean later sold on to Towle, on precisely similar terms, Towle agreeing to pay off and discharge the mortgage. When the mortgage fell due, Marsh called on Towle to pay it off. When Towle failed to do so, Marsh filed a bill attempting to compel the mortgagee, Pike, to foreclose the mortgage, and to compel McLean and Towle to pay it.

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[71] (1888) 39 Ch. D. 636.
[72] *Lockhart* v. *Hardy* (1846) 9 Beav. 349; *Walker* v. *Jones* (1866) L.R. 1 P.C. 50. The latter case, together with *Palmer* v. *Hendrie* (1859) 27 Beav. 349; (1860) 28 Beav. 341 and *Kinnaird* v. *Trollope* (1888) 39 Ch. D. 636 was approved in *Ellis & Co.'s Trustee* v. *Dixon-Johnson* [1925] A.C. 489 and in *In re Bank of Credit and Commerce International S.A. (No. 8)* [1996] Ch. 245, affirmed [1997] 4 All E.R. 568, 580.
[73] Citing *Palmer* v. *Hendrie* (1859) 27 Beav. 349; (1860) 28 Beav. 341.
[74] (1888) 39 Ch. D. 636, 645.
[75] (1859) 27 Beav. 349; (1860) 28 Beav. 341.
[76] As in *Rudge* v. *Richens* (1873) L.R. 8 C.P. 358.
[77] 10 Paige Ch. 595 (N.Y. 1844), affirming 1 Sandf. Ch. 210 (N.Y. 1843).

Walworth C. noted that the effect of the conveyances was to make Marsh a mere surety for the mortgage debt, with McLean and Towle principal debtors with regard to him. As between McLean and Towle, the latter was primarily liable for the debt, and the former secondarily liable. The Chancellor stated

> "The complainant, therefore, if he had paid the bond and mortgage to Pike, would have been entitled to be substituted in Pike's place, not only as to the remedy against the land, but also as to the equitable claim against McLean and Towle who had agreed to pay off the mortgage."[78]

Marsh could not compel Pike to foreclose against McLean and Towle, since there was no reason why he should not pay the mortgagee and take an assignment of the mortgage, and then proceed upon that in order to indemnify himself.[79] However, Marsh did have the right to compel McLean and Towle to pay off and discharge the debt in order to exonerate him.[80] Even though Towle had not directly agreed with Marsh to pay off the debt, Marsh could have a remedy against him as he had agreed with McLean to pay it off and was the owner of the land. If McLean was forced to pay, he would have a remedy over against Towle, "who was in justice and equity bound to pay off and discharge the debt, as between himself and all the other parties to the suit."[81] It was decreed that McLean and Towle should pay Pike the amount of the debt, so as to exonerate Marsh.

Subsequently, Marsh issued execution upon this decree, and McLean was compelled to pay the debt. Pike then assigned the bond and mortgage to McLean, who brought suit upon them against Towle.[82] Towle replied that, by his own exertions, Pike, the mortgagee, had been induced to assign the bond and mortgage to McLean, rather than cancel them. He averred that McLean had, in consideration of Towle's efforts, agreed to forbear from demanding payment from Towle for a certain period. Towle also contended that the mortgage had been discharged by McLean's payment to Pike, and that the decree in *Marsh* v. *Pike* was a bar to this suit. Sandford V.-C. stated:

> "When the mortgage in question was before this court in the suit of *Marsh* v. *Pike* I decided that it was competent for Marsh, on paying the amount of the mortgage to Pike, to enforce its

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[78] 10 Paige Ch. 595, 597 (N.Y. 1844). The "equitable claim" to which Walworth C. referred may be the creditor's supposed right to the benefit of securities or "collateral claims" which a surety was given by the principal debtor: see *ante*. This, however, is circular reasoning: the mortgagee only obtains the "equitable claim" *because* the mortgagor is regarded as a surety and the creditor is supposed to be entitled to enforce the mortgagor's (surety's) rights against the purchaser (principal debtor). Thus, it seems that it is envisaged that the mortgagor is subrogated to his *own* rights against the purchaser.

[79] This accords with the general rule that a surety cannot compel a creditor to have recourse first to the principal debtor; it is otherwise where a "benefit of discussion" is recognised.

[80] This is an analogy to the surety's right of exoneration.

[81] 10 Paige Ch. 595, 597-8 (N.Y. 1844).

[82] *McLean* v. *Towle*, 3 Sandf. Ch. 117 (3rd ed., 128) (N.Y. 1845).

lien in his own name against those who succeeded to him in the title to the equity of redemption. The Chancellor affirmed this doctrine on the appeal from my decree.

> "The same principle extended to McLean, and on his paying the amount, he became entitled to the same remedy against Towle for the collection of the debt out of the mortgaged premises."

McLean's right to this relief was perfect without any assignment of the bond and mortgage. If Pike had refused to assign these, he might have been joined as a party to this suit, and compelled to do so. Pike would have had to have borne the costs of this, so it would not have affected Towle. Therefore, as no assignment would have been necessary for the protection of McLean's rights, there could have been no consideration for the alleged agreement between McLean and Towle, which was therefore not binding, and was no defence.

Sandford V.-C. also stated that the decree in *Marsh* v. *Pike* did not have the effect of extinguishing the mortgage upon payment by McLean, who was in effect the surety:

> "If Towle had paid the amount, the mortgage would have been discharged. But on his surety paying it, equity at once subrogated the surety to the rights of the mortgagee and kept the security on foot for his protection."

Further, the decree in *Marsh* v. *Pike* was not a bar to this suit, as it gave only a personal remedy against Towle. In order for McLean to foreclose and obtain a sale, it was necessary for him to bring this suit.

In *Ross* v. *Schmitz*,[83] a purchaser had impliedly covenanted[84] to pay off the mortgage debt on lands sold to him. When the mortgagor was subsequently compelled to pay the mortgage debt, it was held that he was entitled to an assignment of the mortgage, upon paying the costs of and incidental to the assignment.[85] In *Devenish* v. *Connacher*,[86] a similar decision was made, the vendor being held entitled to an assignment under section 5 of the Mercantile Law Amendment Act 1856.[87] A statutory provision in force in that jurisdiction, however, provided that, upon a sale subject to a mortgage, there was an implied covenant by the purchaser to the mortgagor *and mortgagee* to pay the debt. Thus, as the purchaser was

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[83] (1913) 14 D.L.R. 648.

[84] Under section 89 of the Saskatchewan Real Property Act, by the effect of which, a purchaser of land subject to a mortgage impliedly covenants with the vendor to indemnify him and to pay the mortgage.

[85] See also *Halsey* v. *Reed*, 9 Paige Ch. 446, 453 (N.Y. 1842) *per* Walworth C.; *Calvo* v. *Davies*, 78 N.Y. 211, 217 (1878); *Ayers* v. *Dixon*, 78 N.Y. 318, 323 (1879); *Fish* v. *Glover*, 154 Ill. 86, 93; 39 N.E. 1081, 1083 (1894); *Metzger* v. *Nova Realty Co.*, 214 N.Y. 26, 30; 107 N.E. 1027 (1915); *In re Oster's Estate*, 258 A.D. 930; 16 N.Y.S. 2d 612 (1939).

[86] [1930] 3 D.L.R. 977.

[87] 19 & 20 Vict., c. 97, repealed in Ireland by section 1 and First Schedule of the Statute Law Revision Act 1983. For a detailed discussion of the effect of the repeal, see *ante*.

liable with the mortgagor for the payment of the debt, the section could be applicable. Even assuming that section 5 still has some force in Ireland, a purchaser cannot be regarded as liable with the mortgagor, and thus, the section cannot apply.

Dixon was highly critical of the cases which allowed subrogation to the vendor.[88] He denied that there could be any resemblance to suretyship, on the ground that the purchaser could not be liable to the mortgagee. If the vendor had failed to take security from his purchaser, he should not be allowed to set up the mortgage which he had granted against subsequent mortgagees or purchasers. Since the mortgage had been granted by the vendor, he could not claim to enforce in his own right a debt of his own, even if he had a right of indemnity from a purchaser.

In one unusual case, the purchaser was a trustee with a right of indemnity from the trust beneficiary. When the mortgagor company was compelled to pay the mortgage debt, it was held to have been subrogated to the purchaser's right of indemnity against the beneficiary, which was a first charge on trust assets.[89]

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[88] *Op. cit.*, 84-8.

[89] *Canada Deposit Insurance Corporation* v. *Canadian Commercial Bank* (1987) 46 D.L.R. (4th) 37. However, it was held that the mortgagor was not entitled to be subrogated to any personal right of action which the purchaser trustee might have had against the beneficiary, referring to *Parkview Towers of Hamilton* v. *Canadian Imperial Bank of Commerce* (1980) 116 D.L.R. (3d) 721 and *Williams* v. *Balfour* (1890) 18 S.C.R. 472.

CHAPTER 9

SUBROGATION OF ASSIGNORS OF LEASEHOLD ESTATES

Where a tenant assigned his leasehold interest, at common law, he remained liable to the landlord for payment of the rent.[90] However, in Ireland, Deasy's Act[91] provided that a tenant under a lease[92] should be discharged from liability if the landlord consented to the assignment.[93] Under section 12 of the Act, affirming the common law position, the assignee is liable to the landlord to pay rent. Under section 14, if the assignee assigns again, his liability in respect of further rent ceases after giving notice to the landlord.[94]

Where the original tenant remains liable to the landlord, and is forced to pay, he is entitled to reimbursement of the amount which he has paid from the assignee.[95] He is also entitled to be subrogated to the landlord's rights against the assignee.[96] In one case,[97] the assignee was a company in liquidation. However, the landlord was entitled to recover rent accruing after the commencement of the liquidation as an expense of the liquidation, and it was held that, upon paying the landlord, the original tenant had been subrogated to this right.

It has been seen that a mortgagor who sells land subject to the mortgage may be discharged from liability if the mortgagee does some act which renders it impossible for him to re-convey his interest to the mortgagor if the latter pays the debt.[98] The leading English case[99] denies that this occurs by any

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[90] *Rushden's Case* (1533) 1 Dy. 4; *Walker's Case* (1587) 3 Co. Rep. 22; *Shine* v. *Dillon* (1867) I.R. 1 C.L. 277, 280 *per* Pigot C.B.; *Baynton* v. *Morgan* (1888) 22 Q.B.D. 74.

[91] Landlord and Tenant Law Amendment Act (Ireland) 1860 (23 & 24 Vict., c. 154), section 16.

[92] This does not extend to oral or implied tenancies: J.C.W. Wylie, *Irish Landlord and Tenant Law* (2nd ed., 1998), para. 21.30.

[93] The landlord's consent had to be testified in the manner set down by section 10. Section 10 was repealed by section 35(1) of the Landlord and Tenant (Ground Rents) Act 1967. See Wylie, *op. cit.*, para. 21.30.

[94] See Wylie, *op. cit.*, paras. 21.29-30.

[95] *Moule* v. *Garrett* (1872) L.R. 7 Exch. 101; *Burnett* v. *Lynch* (1826) 5 B. & C. 589; *O'Loughlin* v. *Dwyer* (1884) 13 L.R. Ir. 75. It is not clear whether this is a right to full indemnification. Goff and Jones, *op. cit.*, 443, offer the view that it is not, and therefore, if the lessee has incurred costs in defending himself against the lessor, he cannot recover these from the assignee. In *Electricity Supply Nominees Ltd.* v. *Thorn E.M.I. Retail Ltd.* (1991) 63 P. & C.R. 143, the original tenant was held entitled to reimbursement from a sub-tenant who had covenanted to observe the covenants of the head lease. The tenant is not entitled to a salvage lien on the interest of the assignee, as, *ex hypothesi*, he has ceased to have any interest in the property: *O'Loughlin* v. *Dwyer* (1884) 13 L.R. Ir. 75, 80.

[96] *In re Downer Enterprises Ltd.* [1974] 1 W.L.R. 1460.

[97] *In re Downer Enterprises Ltd.* [1974] 1 W.L.R. 1460.

[98] See *ante*.

[99] *Palmer* v. *Hendrie* (1859) 27 Beav. 349; (1860) 28 Beav. 341.

extension of the well-settled analogous rule of suretyship, although American and Canadian cases have used the analogy.[100]

In the present context, the English Court of Appeal held that a tenant was not discharged from his liability to the landlord for the remaining portion of the rent when the tenant's assignee surrendered part of the demised property to the landlord, any analogy with cases of suretyship being denied.[101] Lord Esher M.R. held that a tenant who assigned the entire of his leasehold interest empowered the assignee to surrender all or part of the premises. Fry L.J., agreeing, stated that the giving of time by the landlord to the assignee would not discharge the tenant. In England and Wales, statute now relieves a tenant of liability to the landlord upon parting with his interest in the land.[102]

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[100] See section 8.7, *ante*.

[101] *Baynton* v. *Morgan* (1888) 22 Q.B.D. 74.

[102] Landlord and Tenant (Covenants) Act 1995 (England and Wales), section 5. See Bridge, "Former Tenants, Future Liabilities and the Privity of Contract Principle: The Landlord and Tenant (Covenants) Act 1995," (1996) 55 C.L.J. 313.

CHAPTER 10

SUBROGATION OF INSURERS

10.1 In General

The insurer's rights differ substantially from those which are accorded to the surety.[1] First, unlike the surety, the insurer has no direct right of action, either in tort or in quasi-contract, to reimburse himself from the third party who is primarily liable. Again, the insurer does not have anticipatory rights against the third party, as the surety has against the principal debtor.

Though the insurer is accorded a right of subrogation at common law where the insurance contract is one of indemnity, and can be given such a right by contract in other cases, the right differs from that of the surety. The most important difference is that in Ireland and England, the insurer can only sue the third party in the name of the insured. The rule is otherwise in France and the United States, where the insurer is frequently compelled to sue in his own name, though it seems that originally in the United States, the insurer could sue in the name of the insured.[2] It seems, judging from the preponderance of authority, that an insurer can only enforce his rights where the insured has been fully indemnified, though this rule may be modified by contract.[3]

As in cases of suretyship, the insurer has a defence similar to the civil law *exceptio cedendarum actionum*, if the insured has interfered with the rights which the insurer may exercise on paying the insured.[4] If the insurer has already paid the insured, only then to discover that the insured has impaired his rights against a third party, the insurer may claim damages from the insured to the extent of the impairment.[5]

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[1] Although an insurer has sometimes been likened to a surety: see *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871).

[2] *Hart* v. *Western Rail Road Corporation*, 13 Metcalf 99, 105-6 (Mass. 1848); *Fretz* v. *Bull*, 12 Howard (U.S.) 466, 469 *per* Wayne J. (1851); *The Propeller Monticello* v. *Mollison*, 17 How. (58 U.S.) 153, 156 (1855); *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871); *Wager* v. *Providence Insurance Co.*, 150 U.S. 99; 14 S. Ct. 55; 37 L. Ed. 1013 (1893). See also S.F. Dixon, *Substituted Liabilities, A Treatise on the Law of Subrogation* (1862), 152-154, and in particular at 154: "it seems to have been generally understood that as the right of action existed in favor of the party sustaining the injury, the action could only be brought in his name..." (then contrasting the decision in a Privy Council appeal from Quebec: *Quebec Fire Insurance Co.* v. *St. Louis* (1851) 7 Moore P.C. 286). The requirement for the insurer to sue in its own name arises from statutes or rules of procedure which provide that every action should be brought in the name of the "real party in interest."

[3] See section 2.3, *ante.*

[4] See, *e.g.*, *Andrews* v. *Patriotic Assurance Company of Ireland (No. 2)* (1886) 18 L.R. Ir. 355, 370-1.

[5] See, *e.g.*, *Globe & Rutgers Fire Insurance Co.* v. *Truedell* [1927] 2 D.L.R. 659; *West of England Fire Insurance Co.* v. *Isaacs* [1897] 1 Q.B. 226; *Co-operative Fire & Casualty Co.* v. *Levesque* (1976) 68 D.L.R. (3d) 553 (C.A., N.B.).

10.2 Direct Action by Insurer against Third Party

The general rule in common law systems is that the insurer's only rights against a third party are derived through the insured. In *Morrison Steamship Co. Ltd.* v. *Greystoke Castle (Cargo Owners)*,[6] Lord Simonds[7] stated that "[t]he insurer has no independent claim in respect of a wrong suffered by the assured, though he may be subrogated to his right and sue in his name with all the consequences that ensue from subrogation." In *Sydney Turf Club* v. *Crowley*,[8] Mason J.A. stated as follows:

> "Where an insurer is subrogated to the rights of an insured against a third party, the insurer does not acquire an independent cause of action against the third party ... the right of action remains unaltered, it is brought in the name of the insured, and it is subject to all the defences which would be available if the action had been brought by the insured for his own benefit."[9]

Further, until the insurer has paid the insured, he has no rights at all against the third party. Although one author[10] has stated that the insurer might bring a "quasi-contractual" action at common law against the third party, he failed to cite any authority. This proposition appears plainly incorrect, because a necessary condition for a quasi-contractual action arising out of the payment of another's debt is that the payment in fact discharged the debt. An insurer's payment to his insured does not have this effect, an issue which is considered in the next section.[11]

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[6] [1947] A.C. 265.

[7] Referring to *Simpson* v. *Thompson* (1877) 3 App. Cas. 279.

[8] [1971] 1 N.S.W.L.R. 724.

[9] Quoted in Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 935. See also Palmer, *op. cit.*, IV, 464 (§ 23.18), note 22 (to the effect that courts have consistently rejected tort claims brought directly by insurers against third parties). In *Hermeling* v. *Minnesota Fire & Casualty Co.*, 548 N.W. 2d 270 (Minn. 1996); [1997] Rest. L. Rev. § 241, note by Kull, a court held, uncontroversially, that the insurer's rights derived from the insured, and were subject to the same limitation period. Kull, commenting on the case, wonders why the insurer's right must be characterised as one of subrogation, rather than indemnity. The court had accepted that a cause of action claiming an indemnity would not arise until the insurer had paid the insured (compare, in the case of sureties, *Wolmershausen* v. *Gullick* [1893] 2 Ch. 514). The answer, according to the theory accepted here, is that the insurer's payment did not discharge the third party, against whom the insured retained his right of action (but *cf. Holloway* v. *State of New Jersey*, 593 A. 2d 716, 720-722 (N.J. 1991), where the court applied the same distinction as in *Hermeling*, stating that a cause of action for indemnification arises when the claimant either pays the creditor, or suffers judgment against himself).

[10] Campbell, "Non-consensual Suretyship," (1935) 45 Y.L.J. 69, 75.

[11] However, a later decision to the contrary is *Michigan Millers Mutual Insurance Co.* v. *United States Fidelity and Guaranty Corporation*, 306 Pa. Super. 88; 452 A. 2d 16 (1982). In that case, judgment had been given against two defendants. In pursuance of its contractual duty, the insurer of the first defendant paid the amount of the judgment, and brought proceedings claiming a contribution or indemnity from the insurer of the other defendant. The court held that the plaintiff insurer was entitled to bring the action. The language used by the court veered between subrogation, contribution and *assumpsit*, at one point referring to the "usual method of enforcing a right of subrogation, by an action in assumpsit": 306 Pa. Super. 88, 93; 452 A. 2d 16, 19 (1982).

10.3 Effect of Insurer's Payment on Liability of Third Party to the Insured

The general rule, which exists subject to few exceptions, is that the insurer's payment to his insured has no effect on the liability of any third party to the insured which arises out of the same fact or facts.[12] In the context of tort law, this is sometimes described as an aspect of the "collateral source" rule, under which the liability of the tortfeasor is not to be reduced by the amount of payments to the victim which arise independently of the tortfeasor's conduct.[13] At one time, the rule may also have obtained justification from the prohibition on assignments of causes of action at law. The insurer was thus seen as being in a situation analogous to that of an equitable assignee of a cause of action, who was required to sue in the name of the insured.[14]

10.3.a Explanations for the Rule

There are a number of reasons why recoveries under insurance policies are not normally taken into account in calculating the amount of an insured's recovery against a third party. First, the third party is not normally a party to the insurance contract, and thus should not be allowed to benefit from it: it is *res inter alios acta.*[15] Kimball and Davies[16] state that a third party, who is neither a party to an insurance contract, nor a specified beneficiary in it, should not be entitled to the benefit of that contract. They add that this is strengthened by the "moralistic basis of tort law as it has developed in our system."[17] Derham[18] observes of this view that it "...is premised on the assumption that the third party would have been the

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[12] The earliest authority establishing the general rule is *Mason v. Sainsbury* (1781) 3 Doug. 61. See also *Clark* v. *Inhabitants of the Hundred of Blything* (1823) 2 B.& C. 254; *Simpson* v. *Thompson* (1877) 3 App. Cas. 279; *Jones* v. *Belfast Corporation* (1897) 32 I.L.T.R. 32; *Ballymagauran Co-operative Agricultural and Dairy Society* v. *County Councils of Cavan and Leitrim* [1915] 2 I.R. 85; *Doyle* v. *Wicklow County Council* [1974] I.R. 55.

[13] *Thompson* v. *Milam*, 115 Ga. App. 396; 154 S.E. 2d 721 (1967); *Mullenberg* v. *K.J. Saxon Construction Company*, 384 S.E. 2d 419, 420 (Ga. App. 1989). See also *Hogan* v. *Steel & Co. Ltd.*, unreported, Macken J., 8th June 1999, 1996 No. 4091 P.

[14] *Cf. The Propeller Monticello* v. *Mollison*, 17 How. (58 U.S.) 153, 156 (1855). After the passing of the Judicature Acts in England and Ireland, an assignment of a cause of action may validly be made at law. It must be made in writing, signed by the assignor, and it becomes effective only upon notification to the debtor.

[15] See, *inter alia*, J. Mestre, *La Subrogation Personnelle* (1979), § 239; Kimball and Davies, "The Extension of Insurance Subrogation," (1962) 60 Mich. L. Rev. 841.

[16] "The Extension of Insurance Subrogation," (1962) 60 Mich. L. Rev. 841.

[17] *Loc. cit.* In *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871), the American Supreme Court denied that the continuance of the third party's liability rested on wrongdoing on its part. See also *Hogan* v. *Steel & Co. Ltd.*, unreported, Macken J., 8th June 1999, 1996 No. 4091 P., at 122-13, quoting from *McElroy* v. *Aldritt*, unreported, Supreme Court, 11th June 1953, Lavery J.

[18] *Subrogation in Insurance Law* (1985), 29-30.

subject of an action by the person suffering the loss even if that person had not had insurance coverage. However in many cases this would not have occurred."[19]

In *Doyle* v. *Wicklow County Council*,[20] Walsh J., speaking *obiter*, expressed the view that the sole basis for the rule was the existence of the insurer's right of subrogation. Therefore, if an insurance policy expressly excluded any right of subrogation, then a third party defendant could plead the policy as a defence to an action by the insurer in the insured's name. However, logic seems to suggest that a defence to an action by the insurer in the name of the insured should also be a defence to an action by the insured on his own behalf against the third party. It seems strange to say that a waiver of subrogation rights by the insurer could bar the insured from recovering from the third party. Again, issues of privity of contract arise. Walsh J. may have envisaged that recovery under the policy would discharge the third party *pro tanto.*

In *Parry* v. *Cleaver*,[21] Lord Pearce envisaged that there might be circumstances in which recovery under the insurance or pension plan discharged *pro tanto* the defendant:

> "It seems to me possible that ... there might be some difference of approach where it is the employer himself who is the defendant tortfeasor, and the pension rights in question come from an insurance arrangement which he himself has made with the plaintiff as his employee."[22]

In *Mark Rowlands Ltd.* v. *Berni Inns Ltd.*,[23] Glidewell L.J. referred to this comment of Lord Pearce as justifying the result in that case, where it was held that an insurer could not bring an action in the name of the insured landlord against a negligent tenant who had the "benefit of the insurance" under the lease, and who had paid a portion of the insurance premiums.[24] However, outside of the particular case where the defendant has the "benefit of insurance," the traditional rule survives. In *National Oilwell (U.K.) Ltd.* v. *Davy Offshore Ltd.*,[25] Colman J. stated that

> "[t]he fact that DOL [the defendant] had already recovered its losses under the policy would be irrelevant by application of the well-established principle confirmed by the House of Lords in

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[19] Instancing family and employer-employee situations. See, *e.g.*, *Lister* v. *Romford Ice and Cold Storage Co. Ltd.* [1957] A.C. 555.
[20] [1974] I.R. 55.
[21] [1970] A.C. 1.
[22] At 37. Dyson J. came to this conclusion in *Page* v. *Sheerness Steel p.l.c.* [1996] P.I.Q.R. Q 26.
[23] [1985] 3 All E.R. 473.
[24] *Cf. Perimeter Investments Ltd.* v. *Ashton Scholastic Ltd.* [1989] 2 N.Z.L.R. 353, 359 *per* Henry J.
[25] [1993] 2 Lloyd's Rep. 582.

Parry v. *Cleaver* ... This case could not on that basis be brought within Lord Reid's exception to the general principle required by considerations of 'justice, reasonableness and public policy.'"[26]

In cases of life insurance and accident insurance, as will be seen later, there is no general right to subrogation. Nonetheless, the collateral source rule applies with undiminished vigour, to the effect that the insurance proceeds are not deductible.[27] This consequence, with its possibilities for double recovery by an insured, has led to calls either (a) to make accident insurance proceeds deductible, or (b) to confer rights of subrogation or "recoupment" on the insurer.[28] As regards the first proposal, Lewis[29] challenges the traditional arguments in favour of permitting a cumulation. First, he points out that it will not always be the case that the plaintiff has paid for the premiums or exercised prudence in providing for the insurance.[30] In many cases, he observes, the insurance will be provided as part of an employee pension scheme, or in other circumstances where there is little element of deliberate planning by the plaintiff (for instance, life insurance taken out when a mortgage is granted). Nonetheless, even in such cases, the plaintiff is ultimately meeting the cost of the insurance. Lewis states that in such cases, the plaintiff's argument for retaining extra benefits is weaker than where he directly arranges for the insurance himself.[31] This does not, however, seem to be clear. Lewis states that there is still less reason for permitting an insured to retain cumulative benefits if he receives payments through social security. Although the plaintiff will have contributed towards this, he has little option but to do so, and there is no element of prudent foresight. This appears to be a sound point. Certain social welfare benefits are deductible in Ireland;[32] the situation in the United Kingdom appears to be complicated.

Lewis also argues that while a plaintiff may have paid for his insurance benefits, he cannot be said to have paid for his tort award, which is the sum which would, on the present hypothesis, actually be reduced.[33] He also argues that plaintiffs do not insure themselves in order to reap a double recovery in the event of an accident caused by the fault of another. Rather, they procure insurance in order to protect themselves in the event of misfortune, however caused. He does not think, therefore, that the deduction of the insurance proceeds from damages for personal injuries would have the effect of depriving the plaintiff of the benefit of the insurance for which he had paid.

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[26] At 606, referring to [1970] A.C. 1, 13.
[27] *Bradburn* v. *Great Western Railway Co.* (1874) L.R. 10 Exch. 1. See also *Hogan* v. *Steel & Co. Ltd.*, unreported, Macken J., 8th June 1999, 1996 No. 4091 P.
[28] Recoupment might merely entitle the insurer to reclaim sums from the insured when the insured has recovered from the third party. As will be seen in section 10.7, *post*, some accident insurance policies provide rights of subrogation in respect of the medical expenses which are paid out on the plaintiff's behalf.
[29] "Deducting collateral benefits from damages: principle and policy," (1998) 18 Legal Studies 15.
[30] *Cf. Bradburn* v. *Great Western Railway Co.* (1874) L.R. 10 Exch. 1.
[31] Lewis, *op. cit.*, at 22.
[32] Hickey, "The Social Welfare and Taxation Implications of a Personal Injuries Award," (1997) 3 Bar Review 141.
[33] Lewis, *op. cit.*, at 23-4.

Finally, and of greatest interest for present purposes, Lewis argues that there is no reason to the distinction between indemnity and non-indemnity forms of insurance. This, however, is really an argument in favour of granting life or accident insurers rights of recoupment or subrogation, and is therefore considered in a later section.[34]

Arguments against deduction included that that damages awarded against a wrongdoer did not always adequately compensate the plaintiff, who should therefore be permitted the benefits of any other source of compensation with which he had provided himself.[35]

10.3.b Consequences of this Rule

Mitchell's theory that subrogation of the insurer occurs in order to prevent the unjust enrichment either of the insured or of the third party has been discussed in section 1.3. A number of criticisms were made there. Other justifications have been advanced for the rule that insurance payments do not discharge the liability of a third party. Quinn[36] well takes the point that subrogation, in enforcing the principle of indemnity, operates to remove the moral hazard that might otherwise exist. In other words, it removes the incentive for insured and potential defendant to collude in the creation of a claim. In this way, it operates in the same manner as other attributes of the principle of indemnity, such as the requirement that an insured have an insurable interest. This is more in the nature of an autonomous feature of insurance law than an aspect of the law of unjust enrichment.

Lewis[37] observes that the conception that one can penalise a wrongdoer by the means of rights of subrogation is somewhat misplaced. Very often, defendants in tort proceedings will be covered by liability insurance. Thus, another insurer will pick up the tab.[38] In the long run, the burden of paying for the costs of material damage should be proportionately spread.[39] In the past, believing that subrogation actions would merely increase legal and administrative costs, British motor insurers entered into "knock for knock" agreements under which they agreed not to pursue each other by means of subrogation for the cost of damage to vehicles.[40] It seems that liability insurers in continental countries enter into "bulk recovery agreements" with social insurers under which they agree to meet fixed proportions of the claims

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[34] See section 10.7, *post*.
[35] Lewis, *op. cit.*, at 29-30.
[36] "Subrogation, Restitution, and Indemnity," (1996) 74 Texas L. Rev. 1361, 1372.
[37] *Op. cit.*, at 36-9.
[38] Of course, where the defendant is not insured, there will often be little point in pursuing him.
[39] This assumes that insurers adopt similar strategies in relation to the risks which they insure.
[40] Lewis, "Insurers' Agreements Not to Enforce Strict Legal Rights: Bargaining with Government and in the Shadow of the Law," (1985) 48 M.L.R. 275.

of the social insurers, rather than meet individual claims by those insurers.[41] Given the predominance of liability insurance, the law of tort offers little deterrent effect.

Lewis notes that the moral hazard does exist in relation to property insurance, but doubts whether it is a serious concern in relation to accident insurance, insureds being reluctant to inflict injury on themselves.[42]

10.4 Direct Restitutionary or Quasi-Contractual Right of Insurer against Third Party

Given that the insurer's payment does not generally discharge the third party, the insurer is not regarded as being entitled to pursue the third party by way of an action for money paid to the use of the third party.[43] This may be contrasted with the position of the surety or co-debtor.[44] Although there does not appear to be a decision directly on point, it would appear that the Motor Insurer's Bureau cannot pursue by way of subrogation an uninsured motorist in respect of whose wrong it has paid a victim. This is because its payment does not *ipso facto* discharge the liability of the third party motorist to the victim. It also appears that the Bureau is not subrogated by operation of law to the victim's rights upon paying him. This seems to follow from the decision of the House of Lords in *The "Esso Bernicia,"*[45] which concerned a voluntary scheme of insurance by tanker owners. In practice, the Bureau demands the execution of a mandate by the third party before it pays the victim, and then pursues the third party by means of that mandate. Furthermore, the Agreement under which the Bureau is established provides that it is a condition precedent of the Bureau's liability to a victim that the victim execute an assignment of his rights against the third party to the Bureau.

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[41] Lewis, "Deducting collateral benefits from damages: principle and policy," (1998) 18 Legal Studies 15, 34, note 69.

[42] Of course, if this were always true, there would be no spurious personal injury claims in respect of self-inflicted wounds, and experience suggests that such a thing is not unknown. Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1357, observes that an insured is better placed to reduce the risk of loss than the insurer. It might thus be argued that the risk of an incomplete recovery from a third party should be placed on the insured, his premium being reduced commensurately. This would minimise the moral hazard. However, as against that, (a) the insured has an incentive to avoid injury, as he will experience pain and suffering, and (b) he may bear an excess in any event, which should serve the same purpose. Greenblatt concludes on this point that, if the risk of an incomplete recovery has any potency in reducing the moral hazard, it would be better allocated by increasing the insured's excess.

[43] See, *e.g.*, C. Mitchell, *The Law of Subrogation* (1994), 5: [RH being the insured, the "third party" the insurer, and PL the wrongdoer] "in the eyes of the law this third party's payment does not have the effect of extinguishing RH's right and of discharging PL's corresponding obligation. As a result, the third party cannot recover his payment from PL directly, as money paid to his use, because PL has technically received no benefit from the payment: his liability to RH subsists." Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1350-2, erroneously supposes that an insurer has a direct right of reimbursement from a third party who is liable to the insured.

[44] See also *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871).

[45] *Esso Petroleum Co. Ltd.* v. *Hall Russell & Co. Ltd.* [1989] A.C. 643.

In Royal Insurance Company of Canada v. *Aguiar*,[46] an insurer had paid its insured, but was unable successfully to pursue a third party in the name of the insured because the insured's right of action was barred by the Statute of Limitations. The insurer then claimed to have a separate, restitutionary, right of action against the third party, on the grounds that it had discharged his liability to the insured. The Court of Appeal of Ontario rejected this contention. Zuber J.A. stated that an essential requirement for restitution to succeed on this ground was that the payment which was made should have discharged the liability of the defendant. However, the insurer's payment had not affected the third party's liability to the insured.

10.5 Insurer's Right to Sums recovered by the Insured

Once he has paid, the insurer's right of subrogation entitles him to exercise rights of the insured in order to recoup the amount which he has paid to the insured. It may occur that after the insurer has paid the insured, and his rights of subrogation have arisen, the insured will receive money or another benefit in diminution of his loss. If this happens, the insurer is entitled to have the value of this benefit, to reduce his loss. This right is not properly an application of the insurer's right of subrogation, but is a separate right, concomitant with it.[47]

This principle was established in *Darrell* v. *Tibbitts*.[48] In that case, a landlord had insured the demised premises. The lease contained a covenant by the tenant to keep the demised premises in repair. Damage occurred to the premises, and the tenants became liable to repair. The insurer paid the landlord, and the tenants subsequently repaired the premises. The insurer now attempted to recover from the landlord the amount which it had paid him. The Court of Appeal allowed this claim, though differing views were expressed on the nature of the right which the insurer possessed.

Brett L.J. stated that there were two grounds on which the insurer could succeed. First, on the basis of an implied promise by the landlord to the insurer at the of payment, that if the tenants made good the loss, the landlord would repay the insurer. Secondly, the insurer, having paid the landlord, was

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[46] (1984) 16 D.L.R. (4th) 477.

[47] Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), state at § 932 (assuming that the insured holds sums he receives from a third party after the insurer has paid on trust for the insurer) that "[t]he trust arises by virtue of the relationship between those parties and subrogation is not a necessary integer." Mitchell, *op. cit.*, 69-70, states that the use of the word subrogation in this context resulted from "flawed reasoning" in *Darrell* v. *Tibbitts* (1880) 5 Q.B.D. 560 and *Castellain* v. *Preston* (1883) 11 Q.B.D. 380, which had been adopted in later cases, "with evil consequences for the clarity of the law in this area." See section 3.9, *ante*. *Cf. Colonia Versicherung A.G.* v. *Amoco Oil Co.* [1997] 1 Lloyd's Rep. 261, 270.

[48] (1880) 5 Q.B.D. 560.

subrogated to his rights, and, when the tenants repaired, "the insurance company are to have the benefit of those repairs." Cotton L.J. based his conclusion that the plaintiff was entitled to recover on its right of subrogation. He observed that the insurer did not have a right to recover back what it had paid (thereby, it seems, implicitly rejecting Brett L.J.'s first ground). However, the insurer did have a right to the benefit of what the insured had received under a contract related to the loss. He stated that the insurer could treat the insured as being under an obligation to use the benefit as the insurer might direct. He stated that the insured could not, however, be deemed to have held the "benefit" in trust for the insurer, as it had been expended in the repair of the house. He appeared to think that the insurer's right of subrogation arose out of an implied contractual term that the insured should hold for the insurer's benefit any amounts which he subsequently received in diminution of his loss. Thesiger L.J. thought that the insurer had an equitable right to recover from the landlord, on "a kind of suit in equity," arising from his right of subrogation, as well as on an action for repayment of the money which the insurer had paid the insured.

In *Castellain* v. *Preston*,[49] property which was the subject of an executory contract of sale was damaged by fire. The vendor's insurer paid him. Under the contract of sale, the vendor was still entitled to the purchase moneys, which he was duly paid. The insurer now brought an action claiming to have the benefit of those purchase moneys. The Court of Appeal held that the insurer was entitled to have the benefit of the sum which the vendor had received from the purchaser. Brett L.J. stated that subrogation arose for the purpose of carrying out the fundamental rule that fire insurance was a contract of indemnity. In order to apply the doctrine of subrogation, the insurer had to be placed in the position of the insured. This extended to the insured's rights which he had already exercised:

> "...the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued, and whether such right could or could not be enforced by the insurer in the name of the assured[50] by the exercise or acquiring of which right or condition the loss against which the assured is insured, can be, or has been diminished."[51]

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[49] (1883) 11 Q.B.D. 380.

[50] It is clear that Brett L.J. did not intend this to include gifts made to the insured. He later referred to *Burnand* v. *Rodocanachi* (1882) 7 App. Cas. 333, in which an insurer was denied the benefit of a sum paid by the United States Government to the insured. He stated that the insured had had no right to the moneys until he had been paid them, and thus this was not a benefit to which the insurer was entitled. He distinguished *Randal* v. *Cockran* (1749) 1 Ves. Sen. 98, on the ground that that case involved a payment by the British Government which was made invariably, and which was therefore regarded as a right of the ship-owner.

[51] At 388.

Brett L.J. added that *Darrell* v. *Tibbitts*[52] had cut away any technical difficulties which might have stood in the way of the insurer. Bowen L.J. agreed with the judgment of Brett L.J.

Cotton L.J. noted that the contract of fire insurance was a contract of indemnity, and that therefore the insurer was bound only to pay the insured the amount of his loss. In order to ascertain the amount of this loss, "everything must be taken into account which is received by and comes to the hand of the assured, and which diminishes that loss." He referred to *Darrell* v. *Tibbitts* as holding that if the insured received a sum of money or a non-pecuniary benefit after receiving payment from the insurer, then the insurer was "entitled to say that the assured is to hold that for its benefit ... [and] when it is received it must be brought into account" between the insurer and insured.[53]

Meagher, Gummow and Lehane[54] were of the view that "in no instance is subrogation a proper description of the right of A. to recoup a payment from B. because it is inequitable or in breach of contract for B. to retain it." Thus, *Castellain* v. *Preston* was not a true case of subrogation. Instead, the authors state that the insurer could have succeeded either on a claim for money had and received or a constructive trust could have been imposed for the benefit of the insurer.[55] As regards the first explanation, this assumes that an action for money had and received is available in respect of performance of a service rather than payment of money.[56] Certainly the latter of these two proffered explanations could not account for the decision in *Darrell* v. *Tibbitts*, as there was no fund to which a trust could attach. In that case, Cotton L.J. said that he did not think that there could be a "trust" where the "benefit" was not in the form of a payment of money, although he held that the insured held for the benefit of the insurer the amount which he later received in diminution of his loss. This appears to have been in the nature of a personal, not a proprietary obligation - there is no fund which can be identified as belonging to insurer.

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[52] (1880) 5 Q.B.D. 560.

[53] In *Doyle* v. *Wicklow County Council* [1974] I.R. 55, 72, Griffin J. stated that "after the insurers have paid the insured under the policy, they have an equity in respect of all the insured's unsatisfied claims. When the insured person receives any benefits from such claims he must account to the insurers therefor and repay to them anything which he receives beyond a complete indemnity." In *British Traders Insurance Co. Ltd.* v. *Monson* (1964) 111 C.L.R. 86, 94, the High Court of Australia commented that "*Castellain* v. *Preston* of course was not a case of subrogation in respect of an outstanding right of action and one might almost wish that some other word had been used as the label of a right which exists when it is too late for subrogation in the ordinary sense." See also Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 932.

[54] *Equity: Doctrines and Remedies* (3rd ed., 1992), § 932.

[55] This latter proposition has become rather controversial. See *Napier* v. *Hunter* [1993] 2 W.L.R. 42, and Mitchell, *op. cit.* and "Subrogation and insurance law: proprietary claims and excess clauses," [1993] L.M.C.L.Q. 192.

[56] The question of what actions can be equivalent to *payment* has already been considered. The answer generally turns on what the parties were willing to accept as payment. Here, the issue is whether or not performance of a service under a contractual obligation can be legally equivalent to payment.

Mitchell states that where an insurer makes a payment to the insured in ignorance of the fact that the insured has already recovered a sum in diminution of its loss from a third party, the insurer is entitled to recover from the insured the excess of the amount of its payment over the total amount necessary to indemnify the insured.[57] He states that the action is one for money had and received by the insured to the use of the insurer, grounded on the insurer's mistake of fact in making the payment. He therefore criticises the decision in *Stearns* v. *Village Main Reef Gold Mining Co.*,[58] where the Court of Appeal held that in those circumstances, an insurer was entitled to recover the amount which the insured had previously recovered from a third party.[59]

In relation to the more important category of cases where the insured receives a sum from the third party after the payment by the insurer, Mitchell states that the insured owes the insurer a duty to account for this sum. He denies that the insurer is entitled to any proprietary rights in any such sum, a topic which is considered in the next section. However, beyond stating that the insured owes a duty to account, Mitchell does not identify the cause of action which the insurer has against the insured.[60] Quinn[61] takes Mitchell to mean that the insurer can sue the insured by means of the equitable suit for account, and queries this proposition, on the basis that that right of action is appropriate where there has been a course of dealing between two parties. Mitchell is careful *not* to describe the insurer's action as one for money had and received. It probably is of little importance precisely how one characterises the insurer's action; the more important question is whether the insurer can claim proprietary rights over sums received by the insured from a third party. The case-law seems unanimous that the insurer can, *pace* Mitchell, although there are differences as to whether a trust or lien should be imposed.

10.6 Proprietary Rights of the Insurer in Sums recovered by the Insured

There have been numerous judicial statements to the effect that, once an insured has been paid by his insurer, he holds any sums which he recovers beyond what is needed fully to indemnify him on trust for the insurer.[62] These statements seem to be derived from the early case of *Blaauwpot* v. *DaCosta*,[63] in

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[57] *Op. cit.*, 80-82.

[58] (1905) 10 Com. Cas. 89.

[59] Derham, *Subrogation in Insurance Law* (1985), 10, adopted the reasoning of the Court of Appeal in *Stearns*. However, later decisions have treated the case as being one where an insurer claimed the amount of an overpayment: *In re Miller, Gibb & Co., Ltd.* [1957] 1 W.L.R. 703, 710-1 *per* Wynn-Parry J.; *Napier* v. *Hunter* [1993] A.C. 713, 751 *per* Lord Browne-Wilkinson.

[60] Cotton L.J. had stated in *Castellain* v. *Preston* (1883) 11 Q.B.D. 380, that the insured was liable to account to the insurer for sums received from third parties. Griffin J. made a similar statement in *Doyle* v. *Wicklow County Council* [1974] I.R. 55, 72.

[61] "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1370-1.

[62] See, *e.g.*, *Hart* v. *Western Rail Road Corporation*, 13 Metcalf 99, 105-6 (Mass. 1848) (stating that the insured holds his *rights of action* against third parties in trust for the insurer); *Gales* v. *Hailman*, 11 Pa. 515 (1849); *Hall* v. *Nashville & Chattanooga Railroad Co.*, 80 U.S. (13 Wall.) 369 (1871); *White* v. *Dobinson* (1844) 14 Sim. 273; 114 L.T. (o.s.) 233; *Commercial Union Assurance Co.* v. *Lister* (1874)

which Lord Northington stated that when an insured received a benefit from a third party, having first been paid by his insurer, then the insured held that benefit in trust for the insurer.[64]

The House of Lords was required to give a considered analysis of the nature of the insurer's rights against the insured in *Napier* v. *Hunter*.[65] In that case, stop loss insurers had paid sums to their insureds, Lloyds' Names, who later recovered a sum from the underwriters who had negligently incurred the loss. The sum so recovered was held by solicitors. The insurers claimed that they had an equitable proprietary interest in these moneys in the hands of the solicitors, the agents of the insureds. Therefore, they claimed that they could require the solicitors to pay the money directly to them rather than have to claim it (presumably by actions for money had and received) from each insured after it had been paid to him.

In his judgment, Lord Browne-Wilkinson noted that there seemed to have been no reported cases in which an insurer brought an action for money had and received against the insured.[66] However, he felt that the insurer did have such a right at common law. Further, there were a number of equity cases[67] which granted the insurer relief against the insured. He felt that the authority of these cases showed that the insurer had an equitable proprietary interest in sums recovered by the insured from third parties.

Although rejecting a contractual origin for the insurer's right of subrogation, it is interesting to note that Lord Browne-Wilkinson proposed a contractual basis for the insurer's right to recover sums later received by the insured. He stated that the contract of insurance contained an implied term that the insured would pay to the insurer out of any funds which later came to hand the amount to which the insurer was entitled by way of subrogation. This contractual obligation was specifically enforceable in equity against the defined fund, in the same way as other contracts to assign or charge specific property. Since equity regarded as done that which ought to be done, the specific performance gave rise to an immediate proprietary right in the moneys recovered from the third party.

L.R. 9 Ch. 483, 484n. *per* Jessel M.R. (*cf.* James L.J. on appeal, at 486, declining to describe the insured as a trustee of the cause of action "in such a way that he is to be deprived of his own free action" on an interlocutory application); *In re Miller, Gibb & Co., Ltd.* [1957] 1 W.L.R. 703; *Forsthove* v. *Hardware Dealers Mutual Fire Insurance Co.*, 416 S.W. 2d 208 (Mo. App. 1967); *Mutual Life Assurance Co.* v. *Tucker* (1993) 119 N.S.R. (2d) 417; 314 A.P.R. 417; noted [1994] Rest. L. Rev. § 98; *In re Casey, A Bankrupt*, unreported, the High Court, Hamilton P., 1st March, 1993, Bankruptcy No. 1799. Meagher, Gummow and Lehane, *op. cit.*, 3rd ed., cite also (at § 932) *In re Palmdale Insurance Ltd. (in liquidation) (No.3)* [1986] V.R. 439, 446-7.

[63] (1758) 1 Ed. 130.

[64] See also *White* v. *Dobinson* (1844) 14 Sim. 273; 114 L.T. (o.s.) 233.

[65] [1993] 2 W.L.R. 42 (H.L.), affirming in part, reversing in part *Napier* v. *Kershaw Ltd.* [1993] 1 Lloyd's Rep. 10 (Saville J. and C.A.).

[66] *Cf. Castellain* v. *Preston* (1883) 11 Q.B.D. 380 and *Darrell* v. *Tibbitts* (1880) 5 Q.B.D. 560, in each of which it seems that the insurer was seeking common law relief, the exact nature of which was ill-defined.

[67] *Blaauwpot* v. *DaCosta* (1758) 1 Ed. 130; *White* v. *Dobinson* (1844) 14 Sim. 273; 114 L.T. (o.s.) 233; *In re Miller, Gibb & Co., Ltd.* [1957] 1 W.L.R. 703.

However, Lord Browne-Wilkinson held, as did the other Law Lords, that this proprietary interest was adequately satisfied by giving the insurer a lien on the fund in the hands of the insured, rather than imposing a constructive trust.[68] The lien would be enforceable against the fund so long as it was traceable and had not been acquired by a *bona fide* purchaser for value. Lord Goff of Chieveley came to the same conclusion as Lord Browne-Wilkinson. He specifically disagreed with Lord Diplock's view that subrogation in the insurance context was a product of an implied term of contract.[69] Again, he felt that the insurer should be granted an equitable lien rather than a constructive trust. Lord Templeman, who broadly agreed with these two Law Lords, stated that equitable interests could arise from contracts. In the present case, an injustice could be done if the insureds were allowed to receive the money before the insurers could realise their rights of "subrogation."

Lord Templeman expressed the view that the insurer's lien applied also to the *right of action* which the insured had against third parties. He acknowledged that it was not necessary to decide this point in the instant case. Lord Goff noted that the point was not an easy one. He did not feel that there was any reason in principle why the insurer's interest should not attach to the right of action. However, a previous decision[70] which held that the insurer did not have the right to control the insured's exercise of his right of action seemed to point in the contrary direction.

Lord Browne-Wilkinson pointedly declined to express a concluded opinion as to this issue. However, he felt that there was an argument of some force to the effect that the insurer's rights in the right of action should be entirely personal. Any equitable proprietary interest in the right of action would have to be based on an implied term of the contract of insurance. If there were such an implied term, it would be based on the previously decided authorities. Other implied terms might, however, be inconsistent with the existence of a proprietary lien on the right of action. For example, the third party could compromise the claim with the insured alone, without needing the concurrence of the insurer. Again, the third party could only obtain a discharge from a judgment if he paid the insured, not the insurer. If the insurer had a proprietary interest in the right of action, this might suggest that the insured on his own could not effect a valid compromise, nor give a good discharge.[71]

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[68] His lordship made passing reference to this point in *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] 2 W.L.R. 802, 830, giving the insurer's right to recover "damages subsequently received by the assured" as an example of a case "where B enjoys rights which, in equity, are enforceable against the legal owner, A, without A being a trustee."

[69] *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330.

[70] *Morley* v. *Moore* [1936] 2 K.B. 359.

[71] See also section 3.9, *ante*. It may be noted here that a Canadian court has held that the universally accepted rule that an abandonment of the insured's right of action against the third party made the insured liable to the insurer if the latter had paid the insured was based on the existence of a trust of the right of action in favour of the insurer: *Co-operative Fire & Casualty Co.* v. *Levesque* (1976) 68 D.L.R. (3d) 553

Mitchell[72] is highly critical of the decision of the House of Lords in *Napier* v. *Hunter*. He accepts that the insureds were under a duty to "account" to the insurer for the sums received from third parties. However, he vigorously disputes the appropriateness of granting the insurer an equitable lien or other proprietary right over the funds received from the third party, as the insurers never had property in the funds which were in the hands of the third party, and so could not be said to have retained a proprietary interest.[73]

As regards this point, it may be queried whether Birks' theory is an appropriate one to apply to these facts. Where a sum comes to the hand of a party, he is free to constitute himself a trustee of it or otherwise create a proprietary interest in it in favour of another party. He may do this in equity by a prior agreement.[74] There cannot be a requirement that the third party should have had some form of proprietary interest in the sum or its traceable antecedent before the interest is created on his behalf. Similarly, there is no conceptual reason why the same should not be possible by operation of law. Birks' theory seems more apposite to cases where the claimant is seeking the return of a sum or of an item which the defendant has obtained from him (*i.e.*, cases of enrichment by "subtraction").[75]

Mitchell also states that the decision is insupportable on the ground put forward by Lord Templeman, that it would be appropriate to grant the insurers a lien as they had not consciously taken the risk of the insureds' insolvency; they had no choice but to pay. This entitled them to preference over the position of unsecured creditors of the insureds. Mitchell disputes this reasoning, on the ground that the insurer had voluntarily chosen to enter into the insurance contract, and that its liability to pay resulted only from that.[76] This appears in substance to be an argument that if the insurer wished to have a lien in these circumstances, it should have provided to that effect in the insurance policy. In this regard, it should be noted that many American insurance policies expressly provide so, thereby putting the matter beyond dispute.[77] Mitchell's argument on this point seems indeed to suggest that there is no real compulsion on

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(C.A., N.B.). The general rule is illustrated by *West of England Fire Insurance Co.* v. *Isaacs* [1897] 1 Q.B. 226.

[72] *Op. cit.*, 82-84.

[73] Mitchell, *op. cit.*, at 83 (and see also 29-32), referring to P. Birks, *An Introduction to the Law of Restitution* (1985), 377 *et seq.*

[74] See, *e.g.*, *Holroyd* v. *Marshall* (1862) 10 H.L.C. 191: see P. Ussher, *Company Law in Ireland* (1986), 419, and cases cited; W.J. Gough, *Company Charges* (2nd ed., 1996), 25-6; R.M. Goode, *Legal Problems of Credit and Security* (2nd ed., 1988), 32-7.

[75] Goff and Jones, *op. cit.*, 85-6, refer to the case as one where the court may have imposed an equitable remedy simply because it would have been unconscionable not to have done so.

[76] Goff and Jones, *op. cit.*, 86, note 80, are sceptical as to whether there is any factor which would justify granting the insurer priority over unsecured creditors in the event of the insured's insolvency.

[77] See *Bernardini* v. *Home and Automobile Insurance Co.*, 64 Ill. App. 2d 465; 212 N.E. 2d 499 (1965); *Miller* v. *Liberty Mutual Fire Insurance Co.*, 48 Misc. 2d 102; 264 N.Y.S. 2d 319 (1965) (each holding that express subrogation provisions in insurance policies had the effect of imposing a lien or trust on

the insurer to pay. If so, then there is no unjust factor entitling them to restitution, which, on Mitchell's theory, would mean that an insurer should not be entitled to subrogation. However, his central thesis is directly to the opposite effect.[78]

Mitchell's final argument why the insurer should not have had a lien is that the insurer in that case was in no more meritorious a position than an insurer who has overpaid his insured and seeks the return of that overpayment. The insurer in the latter case had been denied proprietary relief.[79] In relation to this, the *Stearns* case concerned a mistaken overpayment, and Mitchell himself states that such a payment will not always ground proprietary relief.[80] Lord Browne-Wilkinson stated, in a passage which has already been quoted,[81] that in a case where the insurer seeks the return of an overpayment, there is no fund of money (coming from a third party) which could be the subject of a lien. In a case of the subsequent receipt of funds from a third party, there was a defined fund.

It appears that the most compelling reason for granting the insurer a lien or other proprietary interest is that that accords with the understanding of insurers and insureds for a very considerable time.[82] The fact that at least some insurance policies expressly provide for the lien also supports the view that the decision in *Napier* on this point is in accord with commercial expectations. It is trite that the insurance contract is one of the utmost good faith. That being so, it does not seem incongruous that the insurer's rights as against the insured are of a higher order than that of an unsecured creditor.

In a later first instance decision,[83] Lightman J. stated on the authority of *Napier* v. *Hunter*, that if an *insurer* received a sum from a third party in respect of an insured loss which it had paid, it would hold the sum on trust (a) to secure its own indemnification, and (b) as to the surplus, for the benefit of the insured.[84]

There are some authorities in parallel areas which lend support to the recognition of a proprietary interest in the insurer. In the analogous field of sureties, it has been held that a creditor can be a trustee of

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receipts in the hands of the insured). *Cf. Teichman* v. *Community Hospital*, 87 N.Y. 2d 514; 663 N.E. 2d 628; 640 N.Y.S. 2d 472 (1996); [1997] Rest. L. Rev. § 257, note by Kull.

[78] See section 1.3, *ante*.

[79] *Stearns* v. *Village Main Reef Gold Mining Co.* (1905) 10 Com. Cas. 89.

[80] *Op. cit.*, 30.

[81] [1993] 2 W.L.R. 42, 67.

[82] *Cf.* the analogous argument in the case of sureties: *Hodgson* v. *Shaw* (1834) 3 Mylne & K. 183, 191 *per* Lord Brougham L.C.: "the right [of subrogation] results more from equity than from contract or quasi contract; unless in so far that the known equity may be supposed to be imported into any transaction, and so to raise a contract by implication," quoted with approval in *O'Connor* v. *Malone* (1852) 4 Ir. Jur. 205, 207 (where it was stated that "the parties contract on the basis of that equity").

[83] *Lonrho Exports Ltd.* v. *Export Credit Guarantee Department* [1996] 2 Lloyd's Rep. 649.

sums which he receives from the principal debtor for the surety, after he has been paid by the latter.[85] One may also compare the case of *Hirachand Punamchand* v. *Temple*.[86] The facts of that case were that a son owed a moneylender a sum by a promissory note. The father wrote to the moneylender, offering an amount less than that due under the note, and enclosing a draft for that smaller amount. The moneylender cashed the draft. He later attempted to sue the son for the residue of the amount of the note. He failed in his claim. Farwell and Vaughan Williams L.JJ. made *dicta* to the effect that the moneylender could only have sued for the residue in the capacity of trustee for the father. Since it was clear that the father did not wish the sum to be collected, no action could lie. This decision appears to have envisaged that a payee having a claim in respect of the debt for which he was paid, may be a trustee for the payer, if the third party should be liable prior to the payer. As such, it is analogous to cases of insurance, such as discussed here, and suretyship.

In *In re Casey, A Bankrupt*,[87] Hamilton P. held that the amount which the insured recovered from a third party was subject to a trust in favour of the insurer. However, it appears that the issue may not have been seriously contested in front of him, Hamilton P. merely taking the legal proposition from a textbook.[88]

In *Napier* v. *Hunter*, the court imposed an equitable lien. In *Casey*, Hamilton P. held that a constructive trust arose. The essential difference appears to be that the beneficiary of the trust will be entitled to the whole of the proceeds if the trust property increases in value. The holder of an equitable lien is merely secured to the value of his lien.

An insurer is not entitled to retain a profit made if he recovers more in exercise of one of the rights of the insured than he paid out.[89] It may therefore be congruent with this rule if the insurer is not be allowed to retain any accretion to the sum to which he is entitled. An issue might arise if the sum over which the insurer could exercise his equitable lien was less in value than the amount of the payment which the insurer had made. In such a case, the lien should be to the full value of the insurer's payment, even if the value of the fund to which the lien applies is initially less than the amount of the insurer's payment.

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[84] This is in accordance with the decision in *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330, to the effect that if the recovery from the third party exceeds the total sum paid by the insurer, the surplus belongs to the insured.
[85] See section 7.11, *ante*.
[86] [1911] 2 K.B. 330.
[87] Unreported, the High Court, Hamilton P., 1st March, 1993, Bankruptcy No. 1799.
[88] Goff and Jones, *op. cit.*, (2nd ed., 1978), 428.
[89] *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330.

10.7 Types of Insurance in which Subrogation is available

It is invariably stated that subrogation and its related rights are only available to an insurer under a contract of indemnity. Traditionally all contracts of insurance are regarded as being of an indemnity nature, except for contracts of life or personal accident insurance.[90] A notable tendency has arisen in North America for personal accident or health insurance policies which cover medical expenses to contain express subrogation clauses. Most North American jurisdictions will recognise these clauses.[91] Subrogation in such cases is purely a creature of contract, and is generally subject to the terms contained in the policy. Even in the absence of subrogation clauses, some Canadian courts have gone to the lengths of holding that some disability benefit insurance schemes import an element of indemnity, with a concomitant implicit right of subrogation.[92]

Lewis states that superficially, permitting insurers or providers of benefits to plaintiffs a right of recoupment or subrogation seems more attractive than granting defendants the benefit of those payments by means of deduction.[93] The considerations tending against it were principally the legal and administrative costs involved in the recovery process.

10.8 Payment by the Insurer

The insurer may not exercise any right of subrogation until he has paid the insured the full amount which is due under the policy in respect of that claim.[94] The rationale is that the insurer has no

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[90] *E.g.*, *Mutual Life Assurance Co.* v. *Tucker* (1993) 119 N.S.R. (2d) 417; 314 A.P.R. 417; noted [1994] Rest. L. Rev. § 98.

[91] Some American jurisdictions, however, would (wrongly) regard a subrogation provision in a personal accident policy as amounting to an assignment of a cause of action for personal injury and therefore void: *Forsthove* v. *Hardware Dealers Mutual Fire Insurance Co.*, 416 S.W. 2d 208 (Mo. App. 1967), *Travelers Indemnity Co.* v. *Chumbley*, 394 S.W. 2d 418; 19 A.L.R. 3d 1043 (Mo. App. 1965); *Peller* v. *Liberty Mutual Fire Insurance Co.* 220 Cal. App. 2d 610; 34 Cal. Rptr. 41 (1963); *Berlinski* v. *Ovelette* 164 Conn. 482; 325 A. 2d 239 (1973); *Allstate Insurance Co.* v. *Druke* 118 Ariz. 301; 576 P.2d 489 (1978). In *Harleysville Mutual Insurance Co.* v. *Lea* 2 Ariz. App. 538; 410 P.2d 495 (1966), the court seemed to indicate that the assignment of a claim for personal injuries which had been reduced to judgment or otherwise liquidated would be valid. For a detailed discussion (with lengthy lists of decisions), see G.E. Palmer, *op. cit.*, § 23.18. Upholding the clauses: *DeCespedes* v. *Prudence Mutual Casualty Co.*, 193 So. 2d 224 (Fla. 1966), affirmed 202 So. 2d 561 (1967); *Davenport* v. *State Farm Mutual Automobile Insurance Co.* 81 Nev. 361; 404 P.2d 10 (1965).

[92] *Gibson* v. *Sun Life Assurance Company of Canada* (1984) 6 D.L.R. (4th) 746.

[93] Lewis, "Deducting collateral benefits from damages: principle and policy," (1998) 18 Legal Studies 15, at 32.

[94] *Halliday* v. *High Performance Personnel Pty. Ltd. (in liq.)* (1993) 113 A.L.R. 637, noted by Pynt and Haigh [1993] 9 Int. I.L.R. G-109 (it may be otherwise in a case of an express subrogation clause). See section 2.1, *ante*. *Cf. Capitol Indemnity Corp.* v. *Strike Zone*, 646 N.E. 2d 310, 311 (Ill. App. 4 Dist. 1995) (even a contractual subrogation clause cannot be enforced until the insured had been paid; other authorities cited in the decision).

loss to reduce until he has paid. Again, there can be no risk of the insured making a double recovery before the insurer pays him. An express subrogation clause may grant the insurer the right to bring proceedings against a third party in the name of the insured prior to payment by the insurer.[95] The extent of application of the rule that the insurer has no right of subrogation until the insured has been "made whole" has been discussed in a previous section.[96] The circumstances in which a payment made when an insurer was not legally bound have also been considered in a previous section.[97]

10.9 Rights to which the Insurer may be subrogated

The insurer is entitled to all the rights and benefits of the insured which diminish his loss. The breadth of this rule was laid down by Brett L.J. in *Castellain* v. *Preston*.[98] In *Doyle* v. *Wicklow County Council*,[99] Griffin J. laid down a similarly broad principle:

> "In my opinion, it is beyond argument that all claims of the insured arising out of any ground of legal responsibility vest in the insurer by subrogation."[100]

The insurer's right extends also to rights of action which only arise after the occurrence of the loss.[101]

It must be emphasised that the insurer's rights relate only to rights which diminish the insured's loss: they do not extend to rights which the insured would have enjoyed irrespective of the loss. Thus, an insurer of a hull is not entitled to the insured shipowner's right to freight. This right is independent of the loss, and is not a part of the salvage.[102] Equally, the insurer of a landlord's interest in a demised property should not be entitled to the rent which remains payable by the tenant following destruction of the property.[103] The landlord would have been entitled to this sum even if there had been no casualty.[104]

Some examples of cases in which the insurer has been subrogated to contractual rights of the insured will be listed.

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[95] *Halliday* v. *High Performance Personnel Pty. Ltd. (in liq.)* (1993) 113 A.L.R. 637, noted by Pynt and Haigh [1993] 9 Int. I.L.R. G-109.
[96] Section 2.3, *ante.*
[97] Section 3.8.c, *ante.*
[98] (1883) 11 Q.B.D. 380, 404.
[99] [1974] I.R. 55.
[100] At 72.
[101] *Castellain* v. *Preston* (1883) 11 Q.B.D. 380, 388; *Zurich Insurance Company* v. *Shield Insurance Company Ltd.* [1988] I.R. 174, 178 *per* Gannon J.; 185 *per* McCarthy J.
[102] *Sea Insurance Co.* v. *Hadden* (1884) 13 Q.B.D. 706 (a case in which the ship had been abandoned to the insurer); see M. Clarke, *The Law of Insurance Contracts* (1989), § 31-4A.
[103] See Clarke, *loc. cit.*
[104] Note, however, that the insurer is not restricted to rights which arise *out of* the loss: *Castellain* v. *Preston* (1883) 11 Q.B.D. 380, 404 *per* Brett L.J.

If the insurer paid an insured lessor, he would be held entitled to enforce the lessor's rights against the lessee under the lease, including a repairing covenant.[105] In *Andrews* v. *Patriotic Assurance Company of Ireland (No. 2)*,[106] the insured was the lessor of premises which had been destroyed by fire. The lessee had covenanted to keep the premises in repair. The lessor claimed against the insurer. The latter defended the action on the ground that it had been discharged from liability through the failure of the lessor to exercise his rights under the covenant against the lessee. The court held in favour of the lessor. Palles C.B. stated that if the insurer had paid the lessor, it would then have been subrogated to the lessor's rights under the covenant. However, the failure of the lessor to exercise those rights did not deprive the lessor of its rights against the insurer.[107]

Where insured property is destroyed while the subject of an executory contract of sale, the insurer will be subrogated to the vendor's rights, if any, against the purchaser.[108] The *locus classicus* is *Castellain* v. *Preston*,[109] in which the insurer of a vendor was held entitled to the purchase price once it had been paid to the vendor. It is clear that the insurer would have been entitled to recover the purchase price in the name of the vendor in an action for specific performance.[110]

It may occasionally occur that the insurer will be subrogated to a contractual, or other liquidated claim against a third party in circumstances such that the insured owes a liquidated sum to the same third party. Ordinarily, the insured might be content to exercise a right of set-off, rather than seek to enforce his claim in an active fashion. The insurer would not benefit particularly from such an approach. Nonetheless, the insurer's claim is purely derivative[111]; he can have no different or better right than the insured. Something of a quandary therefore arises: how can the insurer exercise in an active manner (which is productive for him) a right which the insured could only exercise in a passive manner?[112]

In *National Oilwell (U.K.) Ltd.* v. *Davy Offshore Ltd.*,[113] Colman J. stated that in these circumstances, the insurer was entitled to require the insured to exercise all of its rights against the third party. Therefore, the insurer could require the insured to exercise its rights of set-off, and then account to the insurer for the benefit which the insured received through abatement of claim against it. This is really

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[105] *Darrell* v. *Tibbitts* (1880) 5 Q.B.D. 560.
[106] (1886) 18 L.R. Ir. 355.
[107] Palles C.B. referred to the parallel doctrine that mere inaction by a creditor in pursuing the debtor will not generally discharge the surety.
[108] *Castellain* v. *Preston* (1883) 11 Q.B.D. 380; *Budhia* v. *Wellington City Corporation* [1976] 1 N.Z.L.R. 766.
[109] (1883) 11 Q.B.D. 380.
[110] Note also *Brady* v. *Irish Land Commission* [1921] 1 I.R. 56, 67-68.
[111] See sections 10.1 and 10.4, *ante*.
[112] *Cf.* Derham, "Set-Off against an Assignee: the Relevance of Marshalling, Contribution and Subrogation," (1991) 107 L.Q.R. 126, 135, 138, 158.

a species of the right acknowledged in *Castellain* v. *Preston*.[114] It has been seen that the courts are willing to acknowledge a proprietary interest of the insurer in such sums recovered by the insured. It becomes difficult to imagine a proprietary right in a right of set-off. Perhaps any proprietary right arises when a sum is set aside by the insured in its account with the insurer. If this is so, clearly the insurer's rights in such a situation are rather friable.

Perhaps the most commonplace rights to which an insurer can be subrogated are those arising in tort, and in particular in negligence. In *Lister* v. *Romford Ice and Cold Storage Co. Ltd.*,[115] the House of Lords held that an insurer could be subrogated to an employer's right of action against his negligent employee.[116] The insurer may be subrogated to the rights of the insured against a third party under statute. These tend to be rights to compensation rather similar to rights in tort, *e.g.* against a local authority for compensation for malicious injury.[117]

If an insurer pays for a loss of cargo by jettison, he is subrogated to the insured's right to claim a general average contribution from cargo owners or persons with an interest in ship, quite aside from any question of abandonment.[118]

Independently of an abandonment, if the insurer pays the amount of the insured's entire loss in respect of a ship seized and ordered to be sold, apparently without lawful cause, the insurer will be subrogated to the insured's right to claim the proceeds of sale.[119]

The insurer is entitled to interest corresponding to the period after he indemnified the insured, if the insured recovered interest from the third party.[120]

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[113] [1993] 2 Lloyd's Rep. 582.
[114] (1883) 11 Q.B.D. 380.
[115] [1957] A.C. 555.
[116] The result was felt to have adverse implications for labour relations. A gentleman's agreement was subsequently drafted that insurers would not seek to enforce their rights in such cases. *Cf. Morris* v. *Ford Motor Co Ltd.* [1973] Q.B. 792. In Australia, section 66 of the Insurance Contracts Act 1984 (Cth.) denies insurers the right to be subrogated to the rights of employers against employees if the conduct giving rise to the loss arose in the conduct of employment, and did not constitute serious or wilful misconduct; Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 937. *Lister* was approved of by the Supreme Court in *Zurich Insurance Co.* v. *Shield Insurance Co.* [1988] I.R. 174.
[117] *E.g.*, *Doyle* v. *Wicklow County Council* [1974] I.R. 55.
[118] *Dickenson* v. *Jardine* (1868) L.R. 3 C.P. 639.
[119] *Stringer* v. *English and Scottish Marine Insurance Co. Ltd.* (1869) L.R. 4 Q.B. 676, 692.
[120] *H. Cousins & Co. Ltd.* v. *D. & C. Carriers Ltd.* [1971] 2 Q.B. 230, approved by Hutton J. in *Stewarts Supermarkets Ltd.* v. *Secretary of State* [1982] N.I. 286, 295-6. *Cf. Harbutt's "Plasticine" Ltd.* v. *Wayne Tank Pump Co., Ltd.* [1970] 1 Q.B. 447, where it had been thought that the insurer would not be entitled to interest.

Difficult questions arise where the insured receives a voluntary payment in respect of the loss from a third party. The essential question whether or not the insurer is entitled to the benefit of those sums is determined by deciding whether or not they were given in reduction of the loss suffered by the insured. It appears that this is to be decided by having regard to the intention of the third party and the insured, and that this is to be derived from the circumstances surrounding the payment.[121] Many of the cases relate to *ex gratia* compensation payments made by governments as compensation for loss of ships during times of political disturbance. Indeed, these appear to have been the earliest cases in which the issue of the insurer's rights of recourse against third parties arose.

In *Burnand* v. *Rodocanachi*,[122] it was held that insurers were not entitled to the benefit of an *ex gratia* payment from a fund set up by legislative act, which specifically stated that payments were made on the condition that insurers were not to received any money from the fund. Lord Selborne L.C. stated that he was unable to distinguish the case from one of a voluntary gift by an individual. *Randal* v. *Cockran* was distinguishable in that the grant of prize in that case operated in favour of the insurer, on a fair construction of the grant. Lord Blackburn came to the same conclusion, but emphasised that he thought the the essential question was not whether or not the payment was intended as a gift, but whether or not it in fact diminished the loss. Anything which diminished the loss must be deducted from the sum which the insurer is bound to pay. If the insurer had already paid before the insured receives the sum, he would be entitled to that sum.

10.10 Limits on the Insurer's rights

10.10.a Contractual Exclusion

In *Doyle* v. *Wicklow County Council*,[123] Walsh J. stated:

> "... it is possible (though the cases may be few) to have a policy of fire insurance which expressly excludes the right of subrogation. In such a case an insurance company would not be entitled to bring a claim in the name of the applicant."[124]

Walsh J. did not expressly state whether the third party would be entitled to raise this as an objection to an action by the insurer in the name of the insured. However, it may be thought that this was an inevitable implication of his words. Although the third party is not privy to the insurance contract, it

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[121] *Colonia Versicherung A.G.* v. *Amoco Oil Co.* [1997] 1 Lloyd's Rep. 261, 270 *per* Hirst L.J., affirming [1995] 1 Lloyd's Rep. 570.
[122] (1882) 7 App. Cas. 333.
[123] [1974] I.R. 55.
[124] At 64.

appears that courts will seldom prevent it from raising a waiver clause even if the insured is the nominal plaintiff.

Thus, in *The "Surf City,"*[125] a shipper arranged insurance pursuant to a C.I.F. contract. The insurance contract incorporated an exclusion of subrogation rights as against any carrier vessel owned by "a subsidiary or affiliated company," though the policy was vague as to the person to which the company should be affiliated. The carrier company was affiliated to the shipper. A loss occurred. It was eventually accepted that property as well as risk had passed to the buyer. The insurer paid the buyer, and sought to sue the shipper in the name of the buyer. The carrier claimed that the waiver provision excluded a subrogated action against it, on the ground that it was affiliated to the shipper, the original insured, and that the clause had to be understood to refer to companies affiliated with the insured. The insurer argued (through the mouth of the buyer) that the clause referred to companies associated with the payee (*i.e.*, the buyer), and that the waiver did not therefore affect its right to sue in the name of the buyer. On the construction of the clause, Clarke J. held that the affiliates of the insured shipper, including the carrier, were entitled to the benefit of the waiver. It is to be noted that no issue was made of the carrier's entitlement to avail of the clause, though neither it nor the buyer was initially a party to the contract.[126]

10.10.b Limitations on the Rights of the Insured

(i) Set-Off

The insurer can have no greater right than the insured. So, in *In re Casey, A Bankrupt*,[127] it was held that an insurer which was subrogated to its insured's rights against a local authority in respect of damage due to malicious injury, was subject to the authority's right to set-off arrears of unpaid rates. The judge held that the balance of the award of damages, after the set-off had been effected, would be held by the insured on constructive trust for the insurer.[128]

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[125] [1995] 2 Lloyd's Rep. 242.

[126] Mitchell, "Defences to an Insurer's Subrogated Action," [1996] L.M.C.L.Q. 343, 351, note 43, states that the case held that an "insured [could] enforce [a] waiver clause to protect wholly owned subsidiary." However, it was the subsidiary which enforced the clause, not the insured. See also *National Oilwell (U.K.) Ltd.* v. *Davy Offshore Ltd.* [1993] 2 Lloyd's Rep. 582. In *British Telecommunications p.l.c.* v. *James Thomson & Sons (Engineers) Ltd.* [1999] 1 W.L.R. 9, the House of Lords held on a Scottish appeal that the existence of a limited waiver of subrogation as against certain sub-contractors lent support to the existence of a contractual duty of care to the developer by a sub-contractor who was outside the terms of the waiver, even though there was no privity of contract between the developer and the sub-contractor.

[127] Unreported, the High Court, Hamilton P., 1st March, 1993, Bankruptcy No. 1799.

(ii) Defences open to Third Parties against the Insured

Where the insured's right of action against a third party is subject to a defence, such as the expiration of a limitation period, the insurer will be similarly bound by such a defence.[129] This has been used to explain the rule preventing an insurer from attempting to enforce a right of contribution from another insurer by means of subrogation to the insured's rights against the second insurer.[130]

A Canadian case provides a clear example. In *Attorney-General for Canada* v. *Jackson*,[131] the crown had compensated one of its employees who had been injured while travelling as a gratuitous passenger in a motor vehicle. Under a statutory power, the crown sought to indemnify itself by an action against the driver of the vehicle. However, another statutory provision forbade actions by gratuitous passengers against the drivers of the vehicles in which they had been passengers. The Supreme Court held that the crown enjoyed no greater right than that of the person whom it had indemnified. Therefore, its action was barred by the statute.

(iii) Where the Insured ceases to exist

In *M.H. Smith (Plant Hire) Ltd.* v. *Mainwaring*,[132] the insured was a company, which the insurer had paid. The insured company was subsequently liquidated. It was held that since the insured itself could no longer exercise its former rights, neither could the insurer. The proper step would appear to have been an application to put the company back into liquidation.[133] It may occur more frequently that a company has been struck off the register of companies for failure to file annual returns. In such a case, the insurer or other aggrieved party may apply for the restoration of the company to the register.[134]

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[128] A similar decision was reached in *Advanced Airship Corporation Ltd.* v. *Clyde Canvas Goods and Structures Ltd.* [1993-95] Manx L. Rep. 229 (Common Law Division).

[129] *Employers Liability Assurance Corporation* v. *Haidt*, 6 N.J. 471; 79 A. 2d 308 (1951). See also *Holloway* v. *State of New Jersey*, 593 A. 2d 716, 720-722 (N.J. 1991). So, if an insured fails to comply with a notification requirement which is essential to ground jurisdiction, the insurer will equally be bound by that failure: *Recreation World, Inc.* v. *Port Authority of New York and New Jersey*, 1998 U.S. Dist. LEXIS 2738 (S.D. N.Y.).

[130] *Sydney Turf Club* v. *Crowley* [1971] 1 N.S.W.L.R. 724, quoted in section 10.2, *ante*; Meagher, Gummow and Lehane, *op. cit.*, § 935. The court took the view that the second insurer would no longer be liable to the insured once the latter had been indemnified by the first insurer, the case being akin to one of indemnification *aliunde*.

[131] [1946] S.C.R. 489; [1946] 2 D.L.R. 481; 59 C.R.T.C. 273.

[132] [1986] 2 Lloyd's Rep. 244.

[133] In Ireland, the application would be made under section 310(1) of the Companies Act 1963. There is a two year limitation period from the date of dissolution.

[134] The relevant provisions in Ireland are section 311(8) of the Companies Act 1963 and section 12(6) of the Companies (Amendment) Act 1982, under which the directors, members or any other person

(iv) The "Benefit of Insurance"

The insured may contract with a third party that in the event of a casualty occurring, the third party shall have the benefit of any insurance obtained by the insured. The effect of this is that if an insured loss occurs, the insured agrees to seek recompense from the insurer rather than from the third party. This will have the effect of precluding recourse by the insurer against the third party by way of subrogation.[135] The rule should not be confused with that which precludes subrogation of an insurer against a co-insured,[136] although its practical effect is the same.[137]

The majority of cases in which courts have considered "benefit of insurance" provisions have concerned leases.[138] In many cases in the United States, the courts have inferred a waiver of subrogation rights from rather equivocal factors, such as a mere provision that the lessor was to insure. The existence of such a clause may avoid the insurance if the insurer did not consent to it in advance.[139] In *Mark Rowlands Ltd.* v. *Berni Inns Ltd.*,[140] Kerr L.J. said:

> "Provided that a person with a limited interest has an insurable interest in the subject matter of the insurance ... there is no principle of law which precludes him from asserting that an insurance effected by another person was intended to enure for his benefit to the extent of his interest in the subject matter..."[141]

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aggrieved by the striking off of the company may apply for the restoration of the company within twenty years after the date of dissolution.

[135] *The Auditor* (1924) 18 Ll. L. Rep. 464.

[136] See *post.*

[137] In *Surrey Heath Borough Council* v. *Lovell Construction Ltd.* (1990) 24 Con. L.R. 1, Dillon L.J. stated (at 11) that

> "People are free to contract as they like. It may be the true construction that a provision for insurance is to be taken as satisfying or curtailing a contractual obligation, or it may be the true construction that a contractual obligation is to be backed by insurance with the result that the contractual obligation stands or is enforceable even if for some reason the insurance fails or proves inadequate."

The judge also noted, however, that the "benefit of insurance" doctrine was distinct from the prohibition on subrogation against a co-insured, and that the latter prohibition was irrelevant where no claim by an insurer by way of subrogation was in issue.

[138] *General Mills Inc.* v. *Goldman*, 184 F.2d 359 (8th Cir. 1950). See also *Cerny-Pickas & Co.* v. *C.R. Jahn & Co.*, 131 N.E. 2d 100 (Ill. 1955); *United States Fire Insurance Co.* v. *Phil Mar Corporation*, 139 N.E. 2d 330 (Ohio 1956). *Cf. Poslosky* v. *Firestone Fire and Rubber Co.*, 349 S.W. 2d 847 (Mo. 1961).

[139] See *post.*

[140] [1986] 1 Q.B. 211.

[141] [1986] 1 Q.B. 211, 226.

In that case, it was accepted as law by each party that it would not be possible to infer an intention that a party should be relieved of liability by being granted the benefit of insurance, unless it had an insurable interest in the subject matter of the insurance.[142] In this context, it should be noted that a contractual provision stating that a party does not have an insurable interest in property is not conclusive, and the court will consider whether as a matter of fact that party has such an interest.[143] In *Mark Rowlands*, the lessor had covenanted to insure, and the lessee had covenanted to repair the premises and to pay the lessor an "insurance rent." The lessee was to be relieved of his duties to repair and to pay rent in the event of fire.[144] In that event, the lessor was to use the insurance moneys to reinstate the premises devised to the lessee as quickly as possible. The Court of Appeal held that the lessee was not a co-insured,[145] but that under the terms of the lease, it had been meant to have the "benefit of the insurance." The effect of the lease was that the insurance policy was substituted for the liability of the lessee in the event of fire. The intention of the parties, "sensibly construed," must have been that in the event of loss by fire, whether due to negligence or accident, the lessor's loss was to be recouped from the insurer, and in that case, the lessor would have no further claim against the lessee for damages in negligence. To look at matters another way, the lessor had been indemnified by the insurer in a manner envisaged by the lease. He could not therefore claim damages against the lessee as well, so as to obtain a double recovery.

It can be seen from this reasoning that in this situation, the traditional rule, that the third party cannot be discharged by the insurer's payment lest a wrongdoer gain the benefit of a contract between two other persons, is inverted. Thus, the situation where the third party is deemed to have been intended to have the benefit of insurance is an exception to the rule that an insurer's payment does not discharge a third party wrongdoer.

(v) Earlier Proceedings by the Insured

An insurer may be unable to avail of a right of action of the insured's against a third party if the insured has already pursued that cause of action to the point of judgment, or has released the third party from liability as part of a settlement.[146] The insured may, however, bring an action against a third party claiming only in respect of his uninsured loss. The question may then arise whether or not the third party

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[142] [1986] 1 Q.B. 211, 227 *per* Kerr L.J.

[143] *Amexon Realty Inc.* v. *Comcheq Services Ltd.* (1998) 155 D.L.R. (4th) 661 (Ont. C.A.). Indeed, in *Mark Rowlands Ltd.* v. *Berni Inns Ltd.* [1986] 1 Q.B. 211 itself, Kerr L.J. stated (at 228) that provisions in a lease excusing the lessee from repairing or paying rent in the event of destruction by fire could not have the effect of depriving the lessee of an insurable interest.

[144] Relief from the obligation to repair in case of fire does not in itself exculpate the lessee from liability: *T. Eaton Co. Ltd.* v. *Smith* (1977) 92 D.L.R. (3d) 425, 428 *per* Laskin C.J.; *Greenwood Shopping Plaza Ltd.* v. *Neil J. Buchanan Ltd.* (1979) 99 D.L.R. (3d) 289, 291 *per* MacKeigan C.J.

[145] This was, indeed, conceded. As to the relevance of this point, see section 10.10.b (vi), *post.*

[146] *Hilley* v. *Blue Ridge Insurance Company*, 235 N.C. 544; 70 S.E. 2d 570 (1952); *Republic Insurance Co.* v. *Paul Davis Systems of Pittsburgh South, Inc.*, 670 A. 2d 614 (Pa. 1995).

can plead this judgment as a bar to an action by the insurer in the name of the insured for the amount of the insured loss.

In *Taylor* v. *Wray Ltd.*,[147] the Court of Appeal held that insured and uninsured losses were essentially separable items of claim, and therefore, the settlement of a prior action for damages for uninsured loss due to personal injury did not bar a later claim in respect of insured loss.[148] However, in the later case of *Buckland* v. *Palmer*,[149] the same court struck out a claim for insured loss where the insured had already accepted a lodgment in respect of her uninsured loss.[150] In that case, the plaintiff's insurer, acting on the belief that the defendant was insured, had indicated that it would pay the plaintiff, who would, however, have to look to the defendant for the uninsured portion of her loss.[151] The plaintiff issued proceedings claiming the uninsured part of her loss. The defendant paid that amount into court, and the plaintiff's action was accordingly stayed. It later transpired that the defendant was uninsured. The plaintiff's insurers issued new proceedings in her name, claiming the insured part of her loss. This action was stuck out as an abuse of the process of the court. The members of the Court of Appeal stated that there was a public interest in finality in litigation and in protecting persons from being pursued twice for the same claim. There was also a public interest in seeing that justice was done. The competing public interests could be reconciled by holding that (1) it was an abuse of the process of the courts to bring two actions in respect of the same course of action, but (2) where the first action had not proceeded to judgment, it could, in appropriate circumstances, be "revived and amended" so as to permit the entire of the plaintiff's claim to be considered.[152]

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[147] [1971] 1 Lloyd's Rep. 497.

[148] A similar American decision is *Blue Cross & Blue Shield United* v. *Fireman's Fund Insurance Co.*, 140 Wis. 2d 544; 411 N.W. 2d 133 (1987): the insured and insurer were each said to "own" separate parts of the claim after the insurer had paid the insured. When the insured settled with the third party, this was held to extinguish only the claim for uninsured losses. The third party was aware of the insurer's interest when it settled with the insured: see G.E. Palmer, *op. cit.*, 1996 Cumulative Supplement No. 1, to volume IV, at § 23.18 (b), 467 (page 97 of the Supplement). There are, however, other American decisions which hold that insured and uninsured losses (*e.g.*, property damage and personal injuries, respectively) constitute only a single cause of action: Palmer, *op. cit.*, § 23.18 (b). It appears that under the Federal Rules of Civil Procedure, the insurer and insured are both "real parties in interest," each having its own cause of action, and either can sue individually. The defendant might, however, be entitled to require the joinder of the other potential plaintiff: Palmer, *loc. cit. Cf. Phillips* v. *Clifton Manufacturing Co.*, 30 S.E. 2d 146 (S.C. 1944), where the court held that an insurer which had paid the insured and received a loan receipt, was not a necessary party to the suit, and in any event, there was no process by which a defendant could compel the joinder of a plaintiff against its will.

[149] [1984] 1 W.L.R. 1109.

[150] See also *Hayler* v. *Chapman*, *The Times*, 11th November, 1988 and M. Clarke, *The Law of Insurance Contracts* (1989), § 31-5A4.

[151] The reason for this was that the plaintiff's insurers believed that a "knock for knock" agreement applied, under which they waived their rights of subrogation as against other insurers who were party to the agreement.

[152] [1984] 1 W.L.R. 1109, 1114 *per* Sir John Donaldson M.R.

In *Buckland* v. *Palmer*, the first set of proceedings had not proceeded to judgment; they had been stayed when the plaintiff accepted a lodgment. Where judgment had been given, it seems that in one case, a court set aside an earlier judgment for uninsured loss, thereby enabling a claim for the entire of the loss to be brought, on the ground that it would be unjust and inequitable to allow the earlier judgment to stand.[153]

The effect of Article 93 of E.E.C. Regulation 1408 of 1971 may be to require the courts to acknowledge a separate right of action for insured loss vested in insurers in other Member States. Where such a right arises, it has been held that a claim for the insured loss by the insurer (even where it has been assigned back to the insured) is a separate right of action, and a second action in respect of that insured loss was not an abuse of the process of the court, where the insured had already issued proceedings in respect of the uninsured loss.[154]

(vi) The Insurer has no rights against the Insured

Where there is no third party against whom the insured can exercise rights, there can be no subrogation. In *Simpson* v. *Thompson*,[155] the insurer had paid the insured shipowner in respect of loss to one of his vessels owing to a collision. The collision was due to the fault of another ship owned by the insured. The House of Lords denied the insurer any recourse against the insured as owner of the ship responsible for the collision. Two reasons were given for this result. First, the insurer's rights were derived from the insured, and the latter could have no right of action against himself. Secondly, the insurer had contracted to indemnify the insured against loss caused by the negligent acts of another vessel. The ownership of the other vessel was immaterial.

Professor James[156] stated that the insurer should have had a claim in equity against the insured, without the necessity of recourse to notions of subrogation. His view was that subrogation was merely a mechanism which was used by equity to vindicate an existing, underlying right. The underlying right arose in order to prevent an unjust enrichment from occurring. There could have been no question of subrogation in *Simpson* v. *Thompson*, as there were not three parties. The court should, however, have held in favour of the insurer on the basis that the insured, who was at fault in this case, was the person "first liable" for the loss. In other words, for the purposes of the "underlying equity," it was irrelevant that the wrongdoer was the insured.[157] However, the decision seems unexceptionable. It is normally an implied

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[153] *Burns* v. *Cotton*, unreported, Court of Appeal of England and Wales, 3rd February, 1987, cited in M. Clarke, *The Law of Insurance Contracts* (1989), at § 31-5A4.
[154] *Kahl* v. *Holderness Borough Council* [1995] P.I.Q.R. P 401.
[155] (1877) 3 App. Cas. 279.
[156] "The Fallacies of *Simpson* v. *Thompson*," (1971) 34 M.L.R. 149.
[157] Meagher, Gummow and Lehane, *op. cit.*, § 948, disagree, in effect denying that there was any such general underlying equity.

term of the insurer's undertaking with the insured that he will pay even in cases where the loss is attributable to the insured's own negligence. This is part of the reasoning which precludes an insurer from claiming to be subrogated to the insured's rights against a co-insured.[158]

More recent American decisions[159] have refused a right of subrogation to a property insurer where the same insurer had provided liability coverage to the tortfeasor. The general rationale for this approach is that allowing subrogation in such a case would be conducive to abuses, in particular in cases where the liability insured was in part his own insurer, or where there were successive liability insurers.[160] Cozen[161] expressed the view that a "prophylactic" bar on subrogation in such cases was excessively crude. Subrogation should be denied in cases where a risk of abuse seemed to be a genuine danger.[162] The result might perhaps be seen also as support for the view that courts retain a jurisdiction to deny subrogation to an insurer where they deem that it would operate inequitably.[163]

(vii) The Insurer has no rights against a Co-insured

Insurance is often effected in the joint names of several persons for their respective interests, *e.g.* as for mortgagor and mortgagee, or contractor and sub-contractor. The courts may also find that a person has insured to cover the interests of others in the property, even though those persons were not named

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[158] See *Petrofina (U.K.) Ltd.* v. *Magnaload Ltd.* [1983] 3 All E.R. 35; *Stafford Metal Works, Inc.* v. *Cook Paint and Varnish Co.*, 418 F. Supp. 56, 58 (N.D. Tex. 1976); see also *post.*

[159] *Home Insurance Co.* v. *Pinski Bros., Inc.*, 160 Mont. 219; 500 P. 2d 945 (1972) ; *Moring* v. *State Farm Mutual Automobile Insurance Co.*, 426 So. 2d 810 (Ala. 1982).

[160] In *Home Insurance Co.* v. *Pinski Bros., Inc.*, 160 Mont. 219; 500 P. 2d 945, 948-9 (1972), the court identified a number of "mischiefs" which could arise by allowing subrogation in such cases. First, the insurer would be allowed to use the premiums collected from the liability insured in bringing legal proceedings against him. Secondly, such an outcome would give "judicial sanction to the breach of the insurance policy by the insurer"; it would also enable the insurer to obtain insurance from its liability insured which it could later use in an action against him. The insurer would also be enabled to take advantage of a conflict of interest with its liability insured.

[161] *Op. cit.*

[162] Cozen notes (*op. cit.*, at 10, note 22) that the liability insured or a subsequent liability insurer who felt prejudiced by the primary liability insurer's conduct could bring an action claiming conduct in bad faith. Such actions are not uncommon in the United States. The existence of a general duty of "good faith" dealing would not be recognised as having contractual force on this side of the Atlantic. The subsequent liability insurer sometimes claims to have been subrogated to the insured's right of action against the primary liability insurer (*cf. Sydney Turf Club* v. *Crowley* [1971] 1 N.S.W.L.R. 724). More controversially still, the subsequent liability insurer sometimes claims that the primary insurer owed it a direct duty to act in good faith. See Myles, "Bad Faith Disputes Between Primary and Excess Carriers: Theories of Equitable Subrogation / Direct Duty," (1995) 45 F.I.C.C.Q. 218. In any event, Cozen notes that the bar may not operate in cases where the liability insured will in any event bear most of the burden of a judgment against him, *e.g.* where he bears a high excess, or where the plaintiff subrogated insurer is reinsured in respect of the liability risk of the defendant by a captive insurer owned by the defendant itself: *op. cit.*, 15, note 36.

[163] *Cf.* sections 1.6 and 3.5, *ante.*

therein. In such a case, if an insured loss is caused by the fault of a co-insured, the insurer will be denied any right of subrogation to the rights of the insured against the co-insured.[164]

In *Commonwealth Construction Co. Ltd.* v. *Imperial Oil Co. Ltd.*,[165] the Supreme Court of Canada held that where a sub-contractor had an insurable interest in the entire contract works, and was a co-insured under a contractor's all risks policy, then it followed as a "basic principle" of law that the insurer could not claim to be subrogated to the contractor's rights against the sub-contractor. De Grandpré J. stated[166] that the function of this type of policy was

> "to provide to the owner the promise that the contractors will have the funds to rebuild in case of loss and to the contractors the protection against the crippling cost of starting afresh in such an event, the whole without recourse to litigation in case of negligence by anyone connected with the construction, a risk accepted by the insurers at the outset."

The decision in *Commonwealth Construction* seems to have been based on the fiction that in cases of joint insurance, there was in law only one insured, and thus subrogation was impossible. De Grandpré J. stated that

> "[i]n the case of several insurance, if the different interests are pervasive and if each relates to the entire property, albeit from different angles, again there is no question that the several insureds must be regarded as one and that no subrogation is possible."[167]

In *Petrofina (U.K.) Ltd.* v. *Magnaload Ltd.*,[168] Lloyd J. held that a sub-contractor whose fault had caused a loss to the contractor was a co-insured under the policy. He held that the sub-contractor had had

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[164] In the United States, mortgages routinely include a clause requiring joint property insurance. This has resulted in the virtual elimination of subrogation in this context. See Hasson, "Subrogation in Insurance Law, A Critical Evaluation," (1985) 5 O.J.L.S. 416, 430. *Cf. Carpenter* v. *The Providence Washington Insurance Co.*, 16 Peters 495, 501 (U.S. 1842) *per* Story J. It may be noted that, where there are several obligees (creditors) in a bond, and one is a party to the causing of a loss to another, it has been said that a surety in the bond, upon paying the obligee who sustained the loss, is entitled to indemnification from the obligee who was responsible for the loss. In other words, he is not entitled to the "benefit of the suretyship": *Fidelity & Deposit Company of Maryland* v. *Farmers' Bank of Bates County, Mo.*, 44 F. 2d 11, 24 (8th Cir., 1930).

[165] (1976) 69 D.L.R. (3d) 558.

[166] At 566.

[167] The decision followed earlier American cases: *General Insurance Company of America* v. *Stoddart Wendle Ford Motors*, 67 Wash. 2d 973; 410 P. 2d 904 (1966); *Louisiana Fire Insurance Co.* v. *Royal Indemnity Co.*, So. 2d 807 (1949); *New Amsterdam Casualty Co.* v. *Homans-Kohler, Inc.*, 305 F. Supp. 1017 (1969); *Transamerica Insurance Co.* v. *Gage Plumbing and Heating Co.*, 433 F. 2d 1051 (1970); *United States Fire Insurance Co.* v. *Beach*, 275 So. 2d 473 (La. 1973).

[168] [1983] 3 All E.R. 35.

an insurable interest in the entire contract works. He followed *Commonwealth Construction*, and accordingly denied the insurer a right of subrogation against the sub-contractor.

In *Stone Vickers Ltd.* v. *Appledore Ferguson Shipbuilders Ltd.*,[169] Mr. Anthony Colman, Q.C., as he then was, sitting as a Deputy Judge, stated that the basis for the prohibition was a term implied into the contract of insurance, in order to give it business efficacy, that an insurer could not use a right of subrogation to recoup from a co-insured a sum which he had already paid to the insured. Any contrary result would be quite inconsistent with the insurer's obligation to the co-insured under the policy. This approach seems to be consistent with the "one insured" fiction of *Commonwealth Construction.*[170]

10.11 The Insured may not impair the rights to which the Insurer may be subrogated

If the insured renounces a right against a third party, the insurer can no longer be subrogated to that right. In the United States, (and possibly in Ireland and England) an exception is recognised to this rule in cases where the third party had notice of the insurer's right of subrogation.[171] If the insurer is prevented from exercising his rights in this manner, he will be discharged from his obligation to pay, if he has not yet done so.[172] If he has already paid, he will be entitled to recover damages from the insured to the extent of the impairment.[173] This is in accordance with the general rule that the interference with the rights to which one may claim to be subrogated discharges the latter person from liability to pay.[174] It seems that this should follow as a concomitant of the right of subrogation. Palles C.B., however, chose to rest this doctrine on a foundation of implied contract.[175] If the insured prevented the insurer from exercising his rights in this manner, it would be a breach of the insured's duties of the utmost good faith to the insurer. Nonetheless, Palles C.B. used the analogy of the surety:

> "... the surety is discharged, because the law considers that he is entitled, at any moment that he pays the amount, to have all the rights of the creditor, as against the original debtor; and if the creditor puts himself for one moment in such a position that he cannot place the surety, if he then pays, in that position, it is held that the surety is discharged."[176]

If the insurer has already paid when the insured renounces a claim against a third party, the insurer will be entitled to damages against the insured to the amount of the value of the impairment. In

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[169] [1991] 2 Lloyd's Rep. 288.
[170] See the same judge on the same point in *National Oilwell (U.K.) Ltd.* v. *Davy Offshore Ltd.* [1993] 2 Lloyd's Rep. 582.
[171] *Sentry Insurance Co.* v. *Stuart*, 246 Ark. 680; 439 S.W. 2d 797 (1969).
[172] *Hilley* v. *Blue Ridge Insurance Company*, 235 N.C. 544; 70 S.E. 2d 570 (1952).
[173] *West of England Fire Insurance Co.* v. *Isaacs* [1897] 1 Q.B. 226.
[174] As to sureties, see section 7.14, *ante*.
[175] *Andrews* v. *Patriotic Assurance Company of Ireland (No. 2)* (1886) 18 L.R. Ir. 355.

West of England Fire Insurance Co. v. *Isaacs*,[177] a sub-lease obliged the sub-lessor to insure and to lay out the proceeds of the insurance in reinstatement of the premises, in the event of fire. The sub-lessee also insured the premises, and was paid by his insurer after the fire. The sub-lessee then renounced his rights against the sub-lessor under the sub-lease. The Court of Appeal held that the sub-lessee was obliged to pay the insurer the value of the claim which he had renounced.[178]

If the insured *bona fide* settles a claim against a third party prior to payment by the insurer, this is not a breach of the contract of insurance.[179] Although the settlement precludes subrogation against the third party, the insurer has not been prejudiced.[180] If, however, the settlement was not made in good faith, the insured will be obliged to make good to the insurer any loss caused to it by the settlement.[181] Insurance contracts frequently contain express subrogation clauses which prohibit the insured from settling a claim against a third party without the consent of the insurer.[182] If an insurer refuses to pay the insured, it cannot complain of any settlement reached by the insured with a third party.[183] Where the insurer fails to respond to a claim, it may be held to have lost its right to complain of an impairment of its subrogation rights if the

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[176] (1886) 18 L.R. Ir. 355, 370-1.
[177] [1897] 1 Q.B. 226.
[178] See also *Co-operative Fire & Casualty Co.* v. *Levesque* (1976) 68 D.L.R. (3d) 553 (C.A., N.B.), in which the result was the same, based on the theory that the insured was the trustee of the insurer's rights of subrogation. *Cf.* section 3.9, *ante.*
[179] However, some insurance policies contain provisions to the effect that the insurer will not be liable in the event that the insured settles with a third party without obtaining the insurer's consent. Such a clause was upheld as not contravening public policy in *Charest* v. *Union Mutual Insurance Co.*, 113 N.H. 683; 313 A. 2d 407 (1973) and *Stevens* v. *Merchants Mutual Insurance Co.*, 599 A. 2d 490 (N.H. 1991).
[180] See, *e.g.*, *Preferred Risk Mutual Insurance Co.* v. *Courtney*, 393 So. 2d 1328 (Miss. 1981). Simpson, "Cargo Insurer's choice between Subrogation, Equitable Assignment and Legal Assignment in proceedings in Hong Kong," [1997] L.M.C.L.Q. 129, 136 note 55 cites *Causulex Ltd.* v. *Reed Stenhouse Ltd.* (1986) 70 B.C.L.R. 273 to this effect.
[181] *Globe & Rutgers Fire Insurance Co.* v. *Truedell* [1927] 2 D.L.R. 659 (C.A., Ont.), *per* Ferguson J.A.
[182] Simpson, *loc. cit.* In *Stevens* v. *Merchants Mutual Insurance Co.*, 599 A. 2d 490 (N.H. 1991), such a clause was upheld as being an appropriate protection of the insurer's rights of subrogation. Further, it was held that the insurer's right to rely on the clause was not dependent on its ability to point to prejudice on its part (similarly, *Charest* v. *Union Mutual Insurance Co.*, 113 N.H. 683; 313 A. 2d 407 (1973); it seemed that the law of other jurisdictions might require the showing of prejudice (*i.e.*, in the form of the loss of a sum which it could have recovered by way of subrogation from the third party) before the insurer could refuse coverage on this ground: *MacInnis* v. *Aetna Insurance Co.*, 403 Mass. 220; 526 N.E. 2d 1255 (1988); *Rinehart* v. *Hartford Casualty Insurance Company*, 371 S.E. 2d 788 (N.C. App. 1988)). In construing such a provision, another American court held that the failure by an insurer to respond to an offer from the third party communicated by the insured, and consequent failure by the insurer to protect its own right by way of subrogation prevented insurer from relying on a clause requiring its consent to any settlement: *Baith* v. *C.N.A. Insurance Companies*, 593 A. 2d 881 (Pa. Super. 1991). Rather similarly, one court held that an insurer which remained inactive when presented with evidence of the loss by the insured ran the risk that the insured would settle with the third party, and thereby destroy the insurer's subrogation rights: *Markham* v. *Nationwide Mutual Fire Insurance Co.*, 481 S.E. 2d 349 (N.C. App. 1997).
[183] *Roberts* v. *Fireman's Insurance Co.*, 376 Pa. 99; 101 A. 2d 747, 749-750 (1954); *Markham* v. *Nationwide Mutual Fire Insurance Co.*, 481 S.E. 2d 349, 354 (N.C. App. 1997).

insured settles with a third party.[184] In a case where an insurer paid the insured, who then settled with a third party in respect of a claim for insured and uninsured loss, it was held that the insurer was entitled to treat the settlement as including the full amount of insured loss, for which the insured was then liable to account to the insurer.[185] This, however, appears to have turned on the finding that the insured had not acted in good faith in so settling, because it has also been stated that an insured who had been paid by the insurer, but not made whole, was entitled to settle an action against a third party, provided that he acted *bona fide*.[186] In a recent Canadian case, it was held that the unallocated sum recovered from the third party should be apportioned between insurer and insured in the proportion that the insured loss bore to the total loss.[187]

Some American decisions hold that where the third party settles with the insured, knowing of the insurer's claim to subrogation, the third party will not be discharged by its payment to the insured, and will remain liable to the insurer.[188] It is felt that this view is grounded in the prevalent rule in the United

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[184] *Powers* v. *Calvert Fire Insurance Co.*, 216 S.C. 309; 57 S.E. 2d 638, 640 (1950); *North Carolina Board of Architecture* v. *Lee*, 264 N.C. 602, 612; 142 S.E. 2d 643, 650 (1965); *Markham* v. *Nationwide Mutual Fire Insurance Co.*, 481 S.E. 2d 349, 354 (N.C. App. 1997). In the latter case, the court noted that in some circumstances, to protect its interests whatever the outcome, an insurer should bring a declaratory action to determine whether or not it was liable on the policy. Apparently to the contrary is *Associated Hospital Service of Philadelphia* v. *Pustilnik*, 262 Pa. Super. 600, 607 note 1; 396 A. 2d 1332, 1335 note 1 (1979), reversed, but without touching this point, 497 Pa. 221; 439 A. 2d 1149 (1981), where the court stated that a failure by an insurer to intervene in an insured's action against a third party has never been treated as a waiver of the insurer's rights in the proceeds of the action or any settlement thereof.

[185] *Horse, Carriage & General Insurance Co.* v. *Petch* (1916) 33 T.L.R. 131. The courts in Pennsylvania seem to approve of this approach, in the belief that a "*pro rata*" approach would encourage unethical practice, and perhaps perjury: as against the insurer, the insured would be tempted to represent that the amount of the settlement represented only part of the loss, presumably on the ground that the case was weak on liability, while as against the defendant, the insured would assert the strength of the case: *Illinois Automobile Insurance Exchange* v. *Braun*, 280 Pa. 550, 557-8; 124 A. 691, 693 (1924); *Associated Hospital Service of Philadelphia* v. *Pustilnik*, 497 Pa. 221, 225 note 1; 439 A. 2d 1149, 1151 note 1 (1981), affirming (on this ground) 262 Pa. Super. 600, 612; 396 A. 2d 1332, 1338 (1979).

[186] *Commercial Union Assurance Co.* v. *Lister* (1874) L.R. 9 Ch. 483.

[187] *Affiliated F.M. Insurance Co.* v. *Quintette Coal Ltd.* (1998) 156 D.L.R. (4th) 307 (B.C. C.A.). This is a "*pro rata*" approach. The general rule seems to be that the insured must be fully indemnified before the insurer can claim subrogation against a third party or claim a sum which has been recovered by the insured from the third party, whether as in the form of a judgment or a settlement. See section 2.3.d, *ante*. This would dictate a result under which the insured should be entitled to any amount recovered from a third party until he had been reimbursed for the amount of the uninsured loss. However, where the insured has settled his claim, an issue of the *bona fides* of the settlement may arise. Greenblatt, "Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?" (1997) 64 U. Chi. L. Rev. 1337, 1353, criticises the application of the stated rule in the context of settlements, on the ground that it "essentially allow[s] insureds to exchange their insurers' rights of recovery against tortfeasors for low transaction cost settlements."

[188] *Bahn* v. *Shalev*, 125 A. 2d 678, 679-680 (D.C. Ct. App. 1956); *Hospital Service Corporation* v. *Pennsylvania Insurance Co.*, 101 R.I. 708; 227 A. 2d 105, 112 (1967); *Sentry Insurance Co.* v. *Stuart*, 246 Ark. 680; 439 S.W. 2d 797, 799 (1969); *Transamerica Insurance Co.* v. *Barnes*, 29 Utah 2d 101, 106; 505 P. 2d 783, 787 (1972); *Educators Mutual Insurance Association* v. *Allied Property and Casualty Insurance Co.*, 890 P. 2d 1029, 1031 (Utah 1995); *Markham* v. *Nationwide Mutual Fire Insurance Co.*, 481 S.E. 2d 349 (N.C. App. 1997). In such a case, the insured will not be liable to the insurer, as the latter

States that an insurer who has been subrogated should sue in its own name, and not in the name of its insured. Simpson, however, is of the opinion that a similar rule exists in Hong Kong, apparently acting on the presumption that the law of England is the same as that of Hong Kong in all material regards.[189] If one accepts the theory that an insurer has an incipient equitable interest in its insured's right of action against third parties,[190] it might be possible for the insurer to protect that interest by giving the third party notice of its interest, and requiring any payment to be made to it. It should be recalled, however, that unless there has been a legal assignment, the insured is the only person who can give a valid discharge to the defendant or prospective defendant.[191] Thus, even if the insurer notifies the defendant of its interest, unless there has been an assignment, it is felt that if the latter settles with the insured, the insurer's only recourse is against the insured.

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will retain his rights against the third party: *Travelers Indemnity Co.* v. *Chumbley*, 394 S.W. 2d 418; 19 A.L.R. 3d 1043 (Mo. App. 1965).

[189] *Op. cit.*, at 137. However, this view has been expressed by the Supreme Court of Utah (*Educators Mutual Insurance Association* v. *Allied Property and Casualty Insurance Co.*, 890 P. 2d 1029, 1031 (Utah 1995)), even though statute in Utah permits insurers to bring actions by way of subrogation in the name of the insured: Utah Code Ann. § 31A-21-108 ("Subrogation actions may be brought by the insurer in the name of the insured").

[190] *Cf. Co-operative Fire & Casualty Co.* v. *Levesque* (1976) 68 D.L.R. (3d) 553 (C.A., N.B.). See section 3.9, *ante.*

[191] *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330, 341 *per* Diplock J. Simpson makes the same point (*op. cit.*) at 140.

CHAPTER 11

THE SUBROGATION OF PART OWNERS PAYING A CHARGE

11.1 Introduction

The situation often arises that a person having a part interest in property, whether as life tenant, remainderman or co-tenant, will, either in order to safeguard his own interest, or for no explained reason, pay off a charge on the property. In many such cases, a court will hold that he is entitled to the benefit of that charge, unless he indicated by word or deed that he intended the property to stand discharged from the charge. Courts of equity often hold that by his payment, he is *ipso facto* subrogated to the rights of the chargee against all other part-owners of the property.

The general rule is that where a charge is paid off by the owner of the estate burdened by it, it will be presumed that the charge was intended to be extinguished unless there is something to indicate a contrary intent.[1] If it is a matter of indifference to the payer whether or not the charge is to be considered as discharged, then it will be regarded as discharged.[2] Express statements or acts of the parties which are inconsistent with the extinction of the charge will be held to indicate that it remains extant.[3] However, it is accepted that where it would be in the interest of the payer that the charge should be regarded as still subsisting for his benefit, this will be taken as evidence that it was intended to survive, unless there are any indications to the contrary.[4]

It has been seen in a previous chapter[5] that there are conflicting lines of authority as to the effect of payment of a charge by a stranger. Some cases hold that he is presumed to have intended to preserve the charge for his benefit, some that he is not. In the cases discussed in this chapter, there is undoubtedly

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[1] *Purcell* v. *Purcell* (1856) 1 Ir. Jur. (n.s.) 141, 145; *Tyrwhitt* v. *Tyrwhitt* (1863) 32 Beav. 244; *Smith* v. *Smith* (1887) 19 L.R. Ir. 514, 522 *per* Porter M.R.; *In re Butlin's Estate* [1907] 1 I.R. 159; *In re Alexander's Estate* [1938] I.R. 23.

[2] *In re Bury's Estate* [1898] 1 I.R. 379; *In re Toppin's Estate* [1915] 1 I.R. 330.

[3] *Burrell* v. *Earl of Egremont* (1844) 7 Beav. 205; *Tyrwhitt* v. *Tyrwhitt* (1863) 32 Beav. 244; *In re Wallace's Estate* [1907] 1 I.R. 91; *In re Butlin's Estate* [1907] 1 I.R. 159, 163 *per* Wylie J. *Cf. Patten* v. *Bond* (1889) 60 L.T. 583, 585 *per* Kay J. (a case where the payer did not have an interest in the property at the time of payment; the fact that the payer's representatives received payments of interest from the life tenant was held to indicate that the charge was still subsisting).

[4] *In re Bury's Estate* [1898] 1 I.R. 379; *In re Burke's Estate* (1904) 38 I.L.T.R. 174; *Gardner* v. *Astor*, 3 Johns. Ch. 53 (N.Y. 1817); *Robinson* v. *Leavitt*, 7 N.H. 73, 100 (1834); *Bell* v. *Woodward*, 34 N.H. 90 (1856); *Tyrwhitt* v. *Tyrwhitt* (1863) 32 Beav. 244; *In re Nunn's Estate* (1888) 23 L.R. Ir. 286, 292 *per* Monroe J. In *In re Alexander's Estate* [1938] I.R. 23, FitzGibbon J. said (at 34) "In my opinion, to prevent such an extinguishment or 'merger,' there ought to be either existing circumstances, or at least a reasonable probability of their occurrence, in which it would be to the advantage of the owner of the charge and of the estate to preserve their separate existence."

[5] Section 4.1, *ante*.

such a presumption. One with an interest in property is taken to have done what was most in his interest. Certain cases can also be rationalised on the basis of compulsion or mistake. However, restitution lawyers seem to admit that they are dealing with somewhat different territory in these cases,[6] and do not attempt to explain all of the cases on an unjust enrichment analysis. Given that the cases seem to turn on the presumed intention of the payer, it is felt that there is little room for a restitutionary analysis here.[7]

(i) Case of Life Tenant

One of the most common of the early situations arose where a life tenant paid off a charge affecting the inheritance of the estate. If the charge were regarded as discharged, this would have imposed considerable expense on him, to the benefit of the remaindermen. Therefore, the life tenant frequently claimed that the charge had been "kept alive" for his benefit, even where he had not taken an assignment of the mortgage. His right to claim the benefit of a charge so paid off had long been acknowledged. In *Keogh* v. *Keogh*,[8] Sullivan M.R. summarised the position as follows:

> "If a tenant for life of an estate pays off a charge on the inheritance, he is not called upon to do any act in relation to the charge. The law presumes, from the scantiness of his estate, that he intended to keep it alive for his own benefit; but that presumption may be rebutted by an express declaration, or any irrevocable act of the tenant for life merging the charge, and he has the whole period of his life to declare his intention."[9]

However, where a life tenant paid less than the whole value of an incumbrance, and had it assigned to him, or himself assigned it to some other person, it seems that he would not be allowed to

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[6] Sutton, "Payment of Debts Charged upon Property," in A. Burrows (ed.), *Essays on the Law of Restitution* (1991) (chapter 4), 72; Mitchell, *The Law of Subrogation* (1994), 167-170.

[7] Mitchell, *op. cit.*, 167, postulates a form of practical compulsion, in the sense that a part owner may feel obliged to pay off a charge in order to protect himself. He does admit that this compulsion seems rather notional (at 168).

[8] (1874) I.R. 8 Eq. 182, affirmed at 449.

[9] (1874) I.R. 8 Eq. 182, 194-5, affirmed at 449. In *In re Lloyd's Estate* [1903] 1 I.R. 144, such an intention was demonstrated by the life tenant's will. See also *Burrell* v. *Earl of Egremont* (1844) 7 Beav. 205; *Lindsay* v. *Earl of Wicklow* (1873) I.R. 7 Eq. 192, 209 *per* Sullivan M.R.; *In re Butlin's Estate* [1907] 1 I.R. 159, 163, and *In re Gore Booth's Estate* [1910] 1 I.R. 139, 146 *per* Wylie J., observing that where a tenant for life paid off an ordinary mortgage debt, he was "clearly entitled to stand in the shoes of the incumbrancer, and claim against the estate, unless there [was] clear evidence of an intention to make the payment for the benefit of the estate." However, if the tenant for life paid part of a terminable annuity or rentcharge on an estate, which the settlor was under no liability to pay, he would not be entitled to claim recoupment out of the estate against the remainderman. Where a terminable annuity or rentcharge was a debt of the settlor, then it seemed that tenant for life and remainderman should contribute to its payment. In *Gore Booth's Estate*, it was held that a rentcharge on land represented the purchase price, and life tenants who had made payments of it were entitled to be recouped out of the redemption price of the rentcharges that proportion of the amounts they had paid which represented capital.

claim more than the amount which he had paid for it. He could not be taken to have profited at the expense of the estate.[10]

(ii) Tenant in Tail

Although there was a general presumption that a tenant in tail who paid off a charge did so in order to exonerate the estate, this was a rebuttable presumption.[11] Sutton[12] states that the justification for this presumption was that the tenant in tail could at any time bar the entail, and enlarge his interest to a fee simple. If he did not have this right, the same presumption arose as in the case of life tenants.[13] In *Keogh* v. *Keogh*,[14] Sullivan M.R. stated as follows:

> "Where a tenant in tail or tenant in fee pays off a charge on the inheritance, he is, *primâ facie*, supposed to do so in exoneration of the estate; but that presumption may also be rebutted by acts and conduct of the tenant in tail or tenant in fee showing that he intended to keep the charges alive, or by expressions of intention to do so. Those two principles of law, [*sc.*, the presumption against merger in favour of a life tenant, and the present proposition] I believe to be unassailable; they stand on the highest authority."[15]

In *Earl of Buckinghamshire* v. *Hobart*,[16] a tenant in tail paid off a mortgage on the estate, believing that he was the tenant in fee simple. His mistake arose because he was unaware that another party had a life interest in the estate. Even though it was held that the payer's intention at the time of payment had been to extinguish the mortgage, it was nonetheless held that the payer was entitled to claim the benefit of it as against the other persons having an interest in the estate.

A similar decision was *Conolly* v. *Barter*.[17] In that case, a life tenant paid off a charge on the inheritance, and took an absolute release of the lands from the mortgage, under the erroneous belief that he was the owner of the lands in fee simple. At a later time, he became aware that he had a limited interest, and he instructed a solicitor, who sent a case to counsel to advise as to proceedings to have the

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[10] See *Hill* v. *Brown* (1844) 6 Ir. Eq. R. 403, where Sir Edward Sugden L.C. stated that the assignee of a mortgage could only enforce it against the inheritance for the amount which he had paid in circumstances where the life tenant had been a party to the assignment.
[11] See, *e.g.*, *Drinkwater* v. *Combe* (1825) 2 Sim. & St. 340, 368; *Wigsell* v. *Wigsell* (1825) 2 Sim. & St. 364, 368 (no such presumption in case of tenant in tail in remainder); *Adams* v. *Angell* (1877) 5 Ch. D. 634, 645 *per* Jessel M.R.; *In re Pride; Shackell* v. *Colnett* [1891] 2 Ch. 135, 142 *per* Stirling J.
[12] *Op. cit.*, 83-4.
[13] *Op. cit.*, 84, citing *Ware* v. *Polehill* (1805) 11 Ves. 257, 274-5; *Drinkwater* v. *Combe* (1825) 2 Sim. & St. 340.
[14] (1874) I.R. 8 Eq. 182, 194-5, affirmed at 449.
[15] See also *In re Butlin's Estate* [1907] 1 I.R. 159, 163.
[16] (1818) 3 Swanst. 186; see Mitchell, *op. cit.*, 112-3.
[17] [1904] 1 I.R. 130.

charge declared subsisting for his benefit. He did not take any such proceedings. Porter M.R. held that the life tenant's intention at the time when he paid the mortgage was not dispositive. The life tenant was entitled, on discovering his mistake, to have the charge kept alive for his benefit. Although the evidence of the life tenant's expressions of intent conflicted, Porter M.R. decided on balance, that he had indicated an intention to keep the charge alive. The Court of Appeal affirmed this decision.

11.2 Where a spouse with an interest in the property of the other spouse pays a charge on that property

In *Pitt* v. *Pitt*,[18] the presumption against merger was extended to a different set of facts. P., prior to her marriage, had granted a mortgage of her estate. After she married, the mortgage was transferred. The husband joined in the transfer, and covenanted to pay the debt. By a series of gradual payments out of his own property, the husband reduced the amount which was due on the mortgage. The husband predeceased P. It was held that a right of survivorship over the property existed in favour of the wife. The successors to the husband claimed, in succession to the husband, to be "entitled to stand in the place of the mortgagees of the premises for such part of the mortgage money as the testator should be found to have paid off."[19]

Counsel for P., on the other hand, argued that the husband had had an absolute interest in the equity of redemption, subject only to the wife's right of survivorship. Therefore, the husband had to be considered as having paid off the debt for the benefit of the estate. They stated that the case was analogous to one of a tenant in tail paying off an incumbrance. Since this was an equivocal act, the law would presume it to have been for the benefit of the estate, unless the contrary were shown by some declaration of the payer's intention to keep the charge alive. In his judgment, Sir Thomas Plumer M.R. said:

> "in all cases where money is paid off by individuals, not having an absolute permanent interest in the premises, the court looks at the intention; for instance, where a tenant in tail pays off an incumbrance, *prima facie* he is considered as disencumbering the estate, but still the court thinks itself at liberty to look at the intention."[20]

He noted that the husband had seemingly acted under the impression that he was the absolute owner of the property. If P., the wife, came to redeem the mortgage in equity, she had to do equity. He therefore held that the redemption should be on terms that the successors of the husband should "be

[18] (1823) Turn. & R. 180.
[19] (1823) Turn. & R. 180, 181.
[20] (1823) Turn. & R. 180, 183.

permitted to stand in the place of the mortgagee, for the amount in which the husband has reduced the debt."[21]

The *Pitt* decision was followed in *Outram* v. *Hyde*.[22] In that case, a husband paid off a charge on property of which his wife was tenant for life, with a power of appointment by will. She had exercised that power in her will in favour of her husband, though this would only take effect on her death. Hall V.-C. stated that the husband should be regarded as having been subrogated to the position of the chargee:

> "I consider that, unless the clearest evidence was given of an intention on the husband's part to make a present to his wife, he must be held to stand in the place of the incumbrancer whom he pays off."[23]

Thus, there was no presumption of advancement in relation to the payment of the charge.

11.3 Co-owners

Where a co-owner, either joint tenant or tenant in common, pays off a charge on the estate, he will usually be entitled to stand in the position of the chargee as against the interest of the other co-owner. In *In re Curry; Curry* v. *Curry*,[24] a co-owner who had paid off a mortgage affecting the entire of the interest in the land was held entitled to enforce it against his co-tenant. In *Hamilton* v. *Denny*,[25] one joint tenant made advances to the lessor for the payment of a renewal fine. It was held that he was entitled to a lien on the interest of the other joint tenant for the proportion of the fines which should have been paid by the other joint tenant. This lien took priority over the other joint tenant's moiety even though it had been placed in strict settlement.[26]

Though not strictly a case of co-ownership, one may here note the case of *Taylor* v. *Bassett*,[27] in which one of two persons severally seised of distinct parcels of land paid off a mortgage which bound the estates of each of them. It was held that the payer might either treat the mortgage as discharged, and sue the other owner for contribution, or he might treat it as subsisting, and enforce it against the other land to

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[21] (1823) Turn. & R. 180, 184.
[22] (1876) 24 W.R. 268.
[23] *Ibid.* In *Stronge* v. *Johnston*, unreported, Northern Ireland, High Court, Chancery Division, Girvan J., 16th April 1997, 1996 No. 1534 (discussed by Capper, "The Debtor, the Wife, the Farm and the Opportunist," (1997) 48 N.I.L.Q. 400), Girvan J. referred to *Pitt* v. *Pitt* and *Outram* v. *Hyde* as authority for the proposition that one who discharges the "secured obligation" of another becomes entitled to be repaid the sum which he has paid out of that security.
[24] (1898) 25 O.A.R. 267.
[25] (1809) 1 Ball & Beatty 199.
[26] The case was treated as one of salvage. See section 4.6, *ante*.
[27] 3 N.H. 294 (1825).

obtain a "reasonable" contribution.[28] The decision in *Aiken* v. *Gale*[29] was to the same effect.[30] Where one tenant in common paid taxes which were a paramount lien on the interest of each tenant, she was held entitled to enforce that lien as against the interest of the other tenant, in priority to a mortgage which the other tenant had granted of his interest.[31]

In *Olson* v. *Chapman*,[32] the plaintiff was the owner of an undivided one third share in certain land. He paid the entire tax assessed on that land, under the belief that this was necessary in order to save his share of the land from forfeiture. He was held entitled to a lien on the share of his co-tenant to reimburse him for the other tenant's share of the taxes. One commentator noted that at common law, the paying co-tenant's apprehension was correct, and, "upon paying the entire charge against the land, he would be subrogated to the State's lien on the interest of his cotenant."[33] However, in this case, a statute had provided that the co-owner might have been discharged on payment of only his own proper proportion of the tax. The same commentator therefore concluded that "full payment in the circumstances is voluntary, and should not have entitled [the payer] to contribution and subrogation."[34] He felt that the decision was nonetheless justifiable on the ground that the payer had paid in good faith under a mistake of law.[35]

11.4 Payments by Incumbrancers

One of the classic cases of subrogation occurred where a junior mortgagee advanced funds either to the property owner in order to pay a prior mortgagee, or directly paid the mortgagee.[36] Where there is a *contract* between the mortgagor and the junior incumbrancer that the latter should have the benefit of the

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[28] 3 N.H. 294, 298 (1825).
[29] 37 N.H. 501 (1859).
[30] *Cf.* cases such as *Bugden* v. *Bignold* (1843) 2 Younge & Coll. C.C. 377, on which see *post.*
[31] *Freeburg* v. *Farmers' Exchange Bankers* (1922) 63 D.L.R. 142, affirming (1921) 61 D.L.R. 79. It was held that the payer was entitled to the lien, but not to the right to enforce a sale for payment of the back taxes under the relevant legislation. G.B. Klippert, *Unjust Enrichment* (1983), 209, states that unless the payer had paid the tax, the mortgagee would have realised nothing on its claim. If the payer was not granted a lien in priority to the mortgagee, the latter would have been "unjustly enriched" at the expense of the payer. *Cf. Coursolles* v. *Fookes* (1889) 16 O.R. 691, where a subsequent creditor who had successfully impeached the validity of a prior mortgage failed in an attempt to interpose himself ahead of an intermediate incumbrancer who had thus been advanced in priority.
[32] 4 Wash. 2d 522; 104 P.2d 344 (1940), noted (1941) 54 Harv. L. Rev. 521.
[33] (1941) 54 Harv. L. Rev. 521.
[34] He cited *In re Lohr's Estate*, 132 Pa. Super. 125; 200 A. 135 (1938).
[35] As to payments made under mistake of law, see *ante*. *Olson* v. *Chapman* was followed in *Robinson* v. *Robinson*, 14 Wash 2d 98, 104; 126 P. 2d 1090, 1093 (1942). Similarly, *Cook* v. *Vennigerholz*, 44 Wash. 2d 612; 269 P. 2d 824 (1954). There is no entitlement to a lien on the interest of the other co-tenant where the paying co-tenant paid the taxes out of the rentals of the property which he alone received: *McKnight* v. *Basilides*, 19 Wash. 2d 391, 408; 143 P. 2d 307, 315 (1943).
[36] *Bond* v. *Hutchinson* (1878) R.E.D. 443 (N.S. Eq.); *Rosenberg* v. *Quan* (1958) 14 D.L.R. (2d) 415; *Ghana Commercial Bank* v. *Chandiram* [1960] A.C. 732; *Traders Realty Ltd.* v. *Huron Heights Shopping Plaza Ltd.* (1967) 64 D.L.R. (2d) 278.

prior incumbrance, equity will give effect to this even where there is no actual assignment of the prior incumbrance. In *Mackenzie* v. *Gordon*,[37] Lord Cottenham L.C. said:

> "If a subsequent incumbrancer advance money, and it is part of his contract that he shall have an assignment of the prior incumbrance, then he is entitled to stand in the place of that incumbrancer whose debt is paid off by the money which he advances, and whose incumbrance he procures to be assigned to himself."[38]

Even where there has been no agreement, the Court of Appeal of England and Wales has recently stated that where a subsequent incumbrancer pays off a prior one, the subsequent incumbrancer will be subrogated to the rights of the prior incumbrancer even without any agreement to that effect.[39]

Again, where a mortgagee discharges its existing mortgage, and accepts a new mortgage in substitution, in ignorance of a subsequent incumbrance which now stood to gain priority, it has been held that the mortgagee should be allowed to retain the priority of his former mortgage, as it would not have ceded it if it had been aware of the subsequent incumbrance.[40]

11.4.a Payment of a Prior Mortgage by a Subsequent Mortgagee

This was one of the traditional scenarios where the *successio in locum* came into play.[41] Mestre[42] described this institution as responding to "an imperative of equity," namely the transfer of "guarantees of payment" to a person who had paid off a debt, the ultimate burden of which he was not liable to bear.

Under the modern common law, in a case where there is a first legal mortgage, any person having an interest in the equity of redemption is entitled to redeem that first mortgage, and have a

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[37] (1839) 6 Cl. & F. 875, approved by Blackburne L.C. in *Walcott* v. *Condon* (1853) 3 Ir. Ch. R. 1, 14.
[38] At 883. See also *Watts* v. *Symes* (1851) 1 De G., M. & G. 240, where a purchaser of an equity of redemption was held subrogated to a prior incumbrance which he had paid off prior to the conveyance to him, pursuant to his agreement to purchase.
[39] *Faircharm Investments Ltd.* v. *Citibank International p.l.c.*, Court of Appeal of England and Wales, 6th February, 1998, *The Times*, 20th February, 1998 *per* Sir Christopher Staughton: "if a subsequent encumbrancer pays off the debt of someone who has priority over him, he is surely entitled to take over any right or remedy which would have been available to the prior encumbrancer" (quoted from LEXIS transcript).
[40] *Dover Financial Corp.* v. *Basin View Village Ltd.* (1995) 140 N.S.R. (2d) 1; 399 A.P.R. 1; noted [1996] Rest. L. Rev. § 81. While the case was treated as one of "subrogation" to the mortgagee's earlier position, it seems really to be a case of a mortgagee being deemed not to have extinguished his security where it would be contrary to his interest. *Cf. Whiteley* v. *Delaney* [1914] A.C. 132, reversing [1912] 1 Ch. 735 (*sub nom. Manks* v. *Whiteley*), reversing [1911] 2 Ch. 448.
[41] D. 20.4.16, cited by Story, *op. cit.*, § 635, note 2. The same passage was cited with approval and applied by Porter M.R. in *In re Lough Neagh Ship Co.; Ex parte Workman* [1895] 1 I.R. 533, 540.
[42] *La Subrogation Personnelle* (1979), § 15.

conveyance of the first mortgagee's interest.[43] Section 15 of the Conveyancing and Law of Property Act 1881[44] provides that where a mortgagor is entitled to redeem, he shall have power to require the mortgagee, instead of reconveying, to assign the mortgage debt and convey the mortgaged property to any third person, as the mortgagor directs. Section 12 of the Conveyancing Act 1882[45] provides that each incumbrancer should enjoy the same right. It further provides that either the mortgagor or an incumbrancer can exercise the right notwithstanding any intermediate incumbrances. However, "a requisition of an incumbrancer shall prevail over a requisition of the mortgagor, and, as between incumbrancers, a requisition of a prior incumbrancer shall prevail over a requisition of a subsequent incumbrancer."[46]

In *Smithett* v. *Hesketh*,[47] a third incumbrancer, who also held a mortgage which was the first incumbrance on the debtor's property, sought an order in terms that if the second incumbrancer, a jointress, should redeem his first mortgage under sections 15 and 12 of the respective Acts, then that the legal estate should be conveyed to a trustee, and that he, as third incumbrancer, should be at liberty to redeem her by paying her (i) the amount which she had paid to redeem the first mortgage, and (ii) the arrears of interest on her jointure, *but not* the amount of her jointure. She would then convey to him subject to her jointure. It was said that her position would not thereby be altered.

North J. refused to make this order. To have done so would have created a circular result: the jointress could again have redeemed the first mortgage. Such an order would therefore have been futile: if the jointress paid off the first mortgage,

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[43] *Downsview Nominees Ltd.* v. *First City Trust Corporation Ltd.* [1993] A.C. 295, 317-8 (P.C.) *per* Lord Templeman ("It is well settled that the mortgagor and all persons having an interest in the property subject to the mortgage or liable to pay the mortgage debt can redeem"; further holding that, on being offered the amount of the first mortgage debt by the second mortgagee, the first mortgagee was *obliged* to transfer his mortgage to him); *E.N.T. Pty. Ltd.* v. *McVeigh* (1996) 6 Tas. R. 202; 1996 Tas. LEXIS 556, at *11-14; *Bishop of Winchester* v. *Beavor* (1797) 3 Ves. 314; *Steele* v. *Philips* (1821) Beatty 188, 191 *per* Lord Manners L.C. (a judgment creditor); *Fell* v. *Brown* (1787) 2 Bro. Ch. 276 (a subsequent mortgagee); *Rolleston* v. *Morton* (1842) 1 Dr. & War. 171, 177 (*per* Pennefather C.J.), 187 (*per* O'Loghlen M.R.); *Tylee* v. *Webb* (1843) 6 Beav. 552, 557 *per* Lord Langdale M.R.; *Pearce* v. *Morris* (1869) L.R. 5 Ch. 227, 229 *per* Lord Hatherley L.C.; *Tarn* v. *Tanner* (1888) 39 Ch. D. 456, 465 *per* Cotton L.J.; *Home Building and Savings Association* v. *Pringle* (1913) 14 D.L.R. 482; *Peto* v. *Hammond* (1860) 29 Beav. 91, 92; *Caddick* v. *Cook* (1863) 32 Beav. 70; *Griffith* v. *Pound* (1890) 45 Ch. D. 567; *Gee* v. *Liddell* [1913] 2 Ch. 62; *Brown* v. *Crawford*, 252 F. 248, 253 (D.C. Or. 1918) ("any person who is not himself liable as a principal debtor, who is compelled to redeem for the protection of his own lien on mortgaged premises, is entitled to subrogation to the rights of the senior mortgagee"); *Moore* v. *Beasom*, 44 N.H. 215, 218 (1862) *per* Nesmith J., instancing heirs, devisees, executors, administrators and assignees of the mortgagor, subsequent incumbrancers, judgment creditors, and persons having an easement over the land, as persons who might redeem. See also Sheldon, *op. cit.*, § 16. *Cf. Mara* v. *Ryan* (1838) 2 Jones 715, 717 (*per* Joy C.B.); 718 (*per* Pennefather B.): a third party not interested in the equity of redemption is not entitled to an assignment of a mortgage, on paying the mortgagee.

[44] 44 & 45 Vict., c. 41.

[45] 45 & 46 Vict., c. 39.

[46] For England and Wales, see section 115 (1) of the Law of Property Act 1925.

> "she will then stand in the position of first mortgagee; she will then have the right to have the first mortgages assigned, ... her right to have the charges kept alive in some way is absolutely clear."[48]

North J. therefore made the usual order, granting successive periods for redemption to the successive incumbrancers.

In the New Hampshire case *Robinson* v. *Leavitt*,[49] it was stated that the "true principle" upon which the payer of a mortgage debt was entitled to be subrogated to the position of the mortgagee was that the payment of the debt would "operate as a discharge of the mortgage or in the nature of an assignment of it, as may best serve the purposes of justice and the just intent of the parties." Parker J. continued that

> "[m]any cases state the rule in equity to be that the incumbrance shall be kept on foot or considered extinguished or merged, according to the intent or the interest of the party paying the money; but the decisions themselves, it is believed, will generally be found in accordance with the principle above stated."

He emphasised that an assignment was unnecessary. Even if the mortgage had been discharged of record, it could be deemed "still to subsist in him who paid the money, as assignee, so far as it ought to subsist, in the nature of a lien upon the land, and the mortgage be considered in force for his benefit, so far as he ought in justice to hold the land under it, as if it had been actually assigned to him."

In *Bell* v. *Woodward*,[50] the court adopted the above sentiments, stating that the matter was decided by having regard to the justice of the case and the intention of the parties. The court added the gloss that the intention of the parties was the governing principle: "and the intention will be presumed to correspond with the interest of the parties, unless a contrary intention is very plainly expressed, or necessarily implied from the form and nature of the transaction."[51]

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[47] (1890) 44 Ch. D. 161.
[48] (1890) 44 Ch. D. 161, 165.
[49] 7 N.H. 73, 99 (1834). The decision was approved in *Fletcher* v. *Chase*, 16 N.H. 38, 42 (1844). See Sheldon, *op. cit.*, § 13.
[50] 34 N.H. 90 (1856).
[51] This passage was cited with approval in *Gannett* v. *Blodgett*, 39 N.H. 150, 153 (1859); *Aiken* v. *Gale*, 37 N.H. 501 (1859). See also *Hinds* v. *Ballou*, 44 N.H. 619 (1863). *Cf. Mahalakshmammal* v. *Sriman Madhwa Siddhanta Oonnahini Nidhi Ltd.* (1911) I.L.R. 35 Madras 642.

A judgment creditor has sometimes been held entitled to pay off a mortgagee and stand subrogated to his rights.[52] This would have been the case in Ireland prior to the Judgment Mortgage (Ireland) Act 1850.[53] Since that Act, a judgment creditor *per se* is no longer considered to have a lien on the debtor's property. Thus, it seems that he would not be considered to have a sufficient interest to allow him to redeem a mortgage. If, however, he has registered his judgment as a judgment mortgage, this will give him a sufficient interest to redeem a prior mortgage, and claim to have been subrogated to the prior mortgagee's rights.[54] In England and Wales, a judgment creditor who obtains a charging order against real property is entitled, on paying a prior mortgagee of the property, to an assignment of the mortgage and any other security held by the prior mortgagee for the same debt.[55]

In a case where a subsequent mortgagee advances funds to the mortgagor, he can only claim to be subrogated to the rights of a prior mortgagee if he can show that the funds which he advanced were used to pay off that prior mortgage. In *In re Watson's Estate*,[56] Ross J. held that the mere fact that a prior mortgage was paid off on the same day that a subsequent mortgage was granted and funds were advanced by the mortgagee, was not sufficient evidence that the prior mortgage was discharged with the funds advanced by the second mortgagee. The second mortgagee could not therefore claim to have been subrogated to the position of the prior mortgagee.

11.4.b Where subsequent Incumbrancer had undertaken to discharge a prior incumbrance, he may not set it up as against an intermediate incumbrancer

In a rather unusual set of facts, in *Acer* v. *Hotchkiss*,[57] the assignee of a third mortgage had undertaken to the mortgagors to discharge a first mortgage. It was held that, having so undertaken, he could not claim to have been subrogated to the position of the first mortgagee. This was so even though he had been induced to enter into his contract by a fraudulent misrepresentation by the original owner of the property that the second mortgage had been satisfied.[58] It seems arguable he might have been so subrogated as against the second mortgagee if nothing else had occurred. However, after learning of the fraud, the assignee of the third mortgage had enforced the third mortgage against the mortgagors, and obtained judgment against them. It was held that, having affirmed the contract by enforcing it against one party after knowledge of a factor which would have entitled him to rescission, he was bound by it to discharge the first mortgage, and could not raise it as a defence against a second mortgagee. It seems to

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[52] *Carlton* v. *Reeves*, 157 Ga. 602; 122 S.E. 320 (1924).
[53] (13 & 14 Vict., c. 29). See *Steele* v. *Philips* (1821) Beatty 188, 191 *per* Lord Manners L.C.
[54] He will occupy a position at least as strong as the judgment creditor prior to the Act, who was allowed to redeem: *Steele* v. *Philips* (1821) Beatty 188, 191; *Rolleston* v. *Morton* (1842) 1 Dr. & War. 171, 177.
[55] *Faircharm Investments Ltd.* v. *Citibank International p.l.c.*, Court of Appeal of England and Wales, 6th February, 1998, *The Times*, 20th February, 1998.
[56] (1898) 33 I.L.T.S.J. 58 (note); "Marshalling of Securities," (1899) 33 I.L.T.S.J. 185.
[57] 97 N.Y. 395 (1884).

have been correct that the third mortgagee was not allowed to set up the first mortgage against the mortgagors, as he had promised them that he would discharge it.[59] However, it is arguable that, by reason of his mistake as to the subsistence of the second mortgage debt, he might have had an equity as against the second mortgagee. The decision seems to conflict with authority which holds that a purchaser of incumbered property who undertakes to pay off a first charge, but not a second, may be subrogated to the position of the first chargee upon payment to him, as against the second chargee. It would be otherwise if the purchaser had also undertaken to pay off the second charge.[60]

11.5 Cases of Part Payment

In Ireland at least, it seems that there is no reason why a subsequent mortgagee should not be permitted to pay off merely those mortgages which are prior to his, even where a prior mortgagee has a mortgage of a lower priority. This is subject to the prior mortgagee's possible right to tack further advances on to his prior mortgage. These advances will have priority over the subsequent mortgages, if the prior mortgagee did not have notice of the existence of those subsequent mortgages at the time when he made the further advances.[61]

One should also note the effect of the doctrine of consolidation, which was abolished in most cases by statute in 1881,[62] but which may still operate if the parties express an intention in a mortgage deed that they wish it to. This doctrine laid down that a mortgagee of two estates from the same mortgagor could require the mortgagor or the assignees of the equities of redemption of either estate to pay off both mortgages if he sought to redeem only one. Section 17 of the Conveyancing and Law of Property Act 1881[63] provides that a mortgagor seeking to redeem any one mortgage should be entitled to do so without paying any money due under a separate mortgage made by him or one through whom he claims on property *other than that comprised in the mortgage which he seeks to redeem.*

The application of the doctrine to successive mortgages of *one estate* is unclear. In *In re Salmon*,[64] Wright J. held that a mortgagor's trustee in bankruptcy could not redeem a second mortgage without also redeeming a first and third mortgage held on the property which had been assigned to the

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[58] In facts, first and second mortgages were held by the same party, which was quite innocent of the fraud.
[59] *Cf.* Sheldon, *op. cit.*, § 46: "The purchaser of an equity of redemption is entitled to the benefit of a payment made by any one whose duty, as to him, it is to pay the mortgage-debt."
[60] *Wilson* v. *Kimble*, 27 N.H. 300 (1853); *Stone* v. *Davenport Brothers*, 200 Ala. 396; 76 So. 312 (1917); *In re Hubbard* 89 B.R. 920 (Bkrtcy. N.D. Ala. 1988).
[61] *Hopkinson* v. *Rolt* (1861) 9 H.L.C. 514. See further, G.W. Keeton and L.A. Sheridan, *Equity* (3rd ed., 1987), 154-6; Rowley, "Tacking Further Advances," (1958) 22 Conv. 44.
[62] Conveyancing and Law of Property Act 1881 (44 & 45 Vict., c. 41), section 17. In England, see the Law of Property Act 1925, section 93.
[63] 44 & 45 Vict., c. 41.
[64] [1903] 1 K.B. 147; see Keeton and Sheridan, *op. cit.*, 133.

second mortgagee. The first mortgage alone had reserved a right of consolidation. Wright J. stated that section 17 did not apply in a case where there were several mortgages *on the same property*. The judge made the questionable assumption that the doctrine of consolidation applies in a case of successive mortgages on the same property.

On principle, a subsequent mortgagee is in reality no more than an assignee of the equity of redemption, so he may be bound in the same manner as the mortgagor. It has been noted[65] that there seems to be no reason to apply this doctrine to a mortgagor who has granted several mortgages on the same property, as the mortgagor will not be allowed to keep the prior mortgage alive as against the later mortgages.[66] The situation may of course be different as against an assignee of the equity of redemption, who has not undertaken to pay off the prior mortgage. The same is true of a subsequent mortgagee. If *In re Salmon* is correct, an assignee or subsequent mortgagee who wishes to redeem a prior mortgage may have to redeem subsequent mortgages held by the prior mortgagee, even though he has not undertaken to pay them.

As in other situations, if a prior incumbrancer, having received payment in full from a later incumbrancer, surrenders or causes a security which he holds for payment of the debt to be destroyed, thereby making it impossible for the subsequent incumbrancer to obtain the benefit of it, the prior incumbrancer is liable to the subsequent incumbrancer for the amount of the loss the latter thereby suffers.[67]

11.6 Subrogation of Purchasers

In chapter 8, we saw how a purchaser of land subject to a mortgage may in some cases undertake to the vendor to pay it off, and may in other cases merely purchase the "equity of redemption," incurring no personal liability in respect of the mortgage. From the point of view of the purchaser, the consequences of payment of a mortgage or charge may differ depending on whether, as against other parties liable on the debt, or having an interest in the land, he has assumed an obligation to pay the debt.

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[65] R.E. Megarry and H.W.R. Wade, *The Law of Real Property*, (5th ed., 1984), 959 note (28). E.L.G. Tyler (ed.), *Fisher and Lightwood's Law of Mortgage* (10th ed., 1988), 534 note b, observes that the decision applied consolidation to a case of several mortgages on the same property, "probably improperly." *Cf.* C.H.M. Waldock, *Mortgages* (2nd ed., 1950), 285, treating *In re Salmon* as a case of tacking.

[66] *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638.

[67] *Faircharm Investments Ltd.* v. *Citibank International p.l.c.*, Court of Appeal of England and Wales, 6th February, 1998, *The Times*, 20th February, 1998.

11.6.a Purchasers who have assumed the payment of an incumbrance on the estate

If the purchaser undertakes to the vendor to pay off incumbrances on the estate, his obligation to the vendor, makes him, as between those two parties, primarily liable to pay that debt.[68] Where the purchaser has undertaken to pay successive incumbrances on the estate, he will not, on paying a prior one, be held to have succeeded to the rank of the creditor whom he has paid, in order to defeat the claim of subsequent creditors. In *Ryer* v. *Gass*,[69] Ames J. stated that

> [if the mortgage debt] "had been paid by one who was bound by contract or otherwise to pay it, the effect of his doing so would be to extinguish the mortgage."[70]

This is an extension of the rule that one who has successively mortgaged his estate is not allowed to set up the prior mortgage, if he has paid it, against a subsequent mortgagee.[71]

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[68] For a full discussion, see *ante*.

[69] 130 Mass. 227 (1881).

[70] At 229. See also *Malireddi Ayyareddi* v. *Gopalakrishnaya* (1923) L.R. 51 Ind. App. 140, 143 *per* Lord Phillimore (see *post*). See also Sheldon, *op. cit.*, § 46:

> "A purchaser cannot be subrogated to the benefit of an incumbrance which he has agreed to pay... If he himself held the first mortgage, that is extinguished by his assumption of both burdens ... Upon payment of a mortgage debt from the funds of the debtor and also from those of a third party, the mortgage can be kept alive only to the extent of the latter funds."

(Citations omitted).

[71] *Platt* v. *Mendel* (1884) 27 Ch. D. 246; *Watts* v. *Symes* (1851) 1 De G., M. & G. 240, 244 (*per* Knight Bruce L.J.: "It is plain that a person who borrows money cannot be his own creditor, or set up an incumbrance of his own against his creditor"); *In re Davison's Estate* (1893) 31 L.R. Ir. 249, 255 *per* Monroe J.: "It is entirely a different matter when a first mortgage is paid off by the mortgagor himself. He is, at all events where there is no sufficient evidence of a contrary intention, presumed to have paid off a first incumbrance for the benefit of subsequent incumbrancers whose claims he is bound to pay. But such a presumption does not arise where the first incumbrance is paid off by a surety who is not in privity with, and has undertaken no obligation to subsequent incumbrancers for the discharge of their debts"; *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638; *Ratner* v. *Gordon*, 118 A. 338 (N.J. Ch. 1922); *Flemington National Bank & Trust Co.* v. *Sindlinger*, 1 N.J. Super. 581; 62 A. 2d 498 (1948); *Parkash* v. *Irani Finance Ltd.* [1970] Ch. 101. In *Boscawen* v. *Bajwa* [1995] 4 All E.R. 769, 784, Millett L.J. said "equity does not permit the debtor himself to obtain priority to subsequent incumbrancers by paying off his mortgage and then keeping it alive against them; still less does it permit the debtor to gain parity with his own mortgagee by paying off part of the mortgage and then keeping it alive against him." Where a debtor pays off one of two incumbrances which rank *pari passu*, he is not allowed to raise that which he has paid in competition with the remaining one: *In re W. Tasker & Sons Ltd.* [1905] 2 Ch. 587. However, where mortgagor had assigned his interest and been discharged from bankruptcy, and thus was no longer liable to the mortgagee, there was no reason why, on paying the mortgage, he could not take an assignment of it and set it up against the estate: *In re Howard's Estate* (1892) 29 L.R. Ir. 266. In *In re The Cork Harbour Docks and Warehouse Co. Ltd.'s Estate* (1885) 17 L.R. Ir. 515, Palles C.B. said (at 527), "when the owner of an estate pays off his own debt charged upon his estate, there is an irrebuttable presumption as between him and the persons who have puisne charges on his estate, and are not parties to the transaction, that such payment must be attributed to the character of debtor, and not to an alleged character of purchaser, and that, in a Court of Equity, it must be irrebuttably presumed that the owner of the estate did that which he

The extension is justified on the ground that the purchaser is, as between himself, the vendor and all the creditors, the payment of whose claims he has assumed, the person primarily liable for each of those debts. Therefore, he cannot, by paying one such debt, attempt to shift its burden onto a subsequent creditor, by setting up the incumbrance which he has paid.[72] The meaning of the transaction between vendor and purchaser was that the payment of these incumbrances was a part of the consideration from the purchaser. Therefore, when the purchaser pays off an incumbrance, it will be considered as having been discharged, as far as concerns subsequent incumbrancers *whose claims the purchaser had undertaken to pay*.

Where the purchaser assumes the payment of a prior mortgage, but not of a subsequent mortgage, he should not be debarred from setting up the first mortgage against the second mortgagee, if he pays the first.[73] Similarly, where the purchaser assumes payment of a prior mortgage, and pays it off, ignorant of subsequent liens on the property, he will be held to have been subrogated to the benefit of the mortgage.[74] An example of such a case, which also involved a fraud by the vendor, was *Wilson* v. *Kimble*,[75] which has been considered earlier.[76] There, a purchaser had assumed the payment of a first

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was bound to do, by reason of his being the debtor himself, namely, that he paid off his debt, and did not become a purchaser of it for the purpose of keeping up his own debt against his own creditor." He also posited a possible alternative explanation (at 527-8): if a mortgagor granted two mortgages, the latter containing a covenant for further assurance, the mortgagor will be bound to grant further assurance if he acquires any interest in the property in priority to the second mortgagee. It is not clear whether a transferee of the mortgagor's interest would be similarly bound.

[72] *Muhammed Sadiq* v. *Ghaus Muhammed* (1910) I.L.R. 33 Allahabad 101.

[73] In *Adams* v. *Angell* (1877) 5 Ch. D. 634, the purchaser was the first mortgagee. The decision received approval in *In re Howard's Estate* (1892) 29 L.R. Ir. 266, 273-4. In another, rather peculiar case, the assignee of a mortgage purchased the equity of redemption, *covenanting with the mortgagor* to pay off the mortgage. Pursuant to its agreement with the mortgagor-vendor, the assignee-purchaser then granted a mortgage to the mortgagor-vendor, expressed to be subject to the earlier mortgage. The Court of Appeal held that, on the construction of the agreement, the earlier mortgage remained subsisting: *In re The Cork Harbour Docks and Warehouse Co. Ltd.'s Estate* (1885) 17 L.R. Ir. 515. *Cf. O'Loughlin* v. *Fitzgerald* (1873) I.R. 7 Eq. 483, where a first mortgagee purchased the equity of redemption in such a way that the mortgage merged with it; Chatterton V.-C. held that this had had the effect of letting in an intermediate burden (a lease).

[74] See *Clute* v. *Emmerich*, 99 N.Y. 342, 352-3; 2 N.E. 6, 21 (1885). Successive purchasers who had assumed the payment of a first mortgage, and other mortgages which were substituted for it (the mortgagees being successively subrogated to the former rights of the first mortgagee) were held to be subrogated to the rights of those mortgagees as against a subsequent judgment creditor, of whose lien they had not had notice. Finch J., on behalf of the court, said:

> "in no just sense can it be said, as against one claiming under the judgment, that the owners of the fee were bound to pay off the [mortgage]. While they had agreed to do so as to other parties, and as to them were primarily liable, they stood in no such relation to the [judgment creditor], and owed her no such duty."

See also *Stone* v. *Davenport Brothers*, 200 Ala. 396; 76 So. 312 (1917); *In re Hubbard* 89 B.R. 920 (Bkrtcy. N.D. Ala. 1988).

[75] 27 N.H. 300 (1853).

mortgage on property, which he paid in due course. The vendor of the property had lied to the purchaser, telling him that a second mortgage on the property had been paid and satisfied. The mortgage in fact had not been paid, but had been assigned by the mortgagee to a third party. The mortgagee later falsely recorded a discharge in his own name in the land registry. The assignee of the second mortgage was unaware of the fraud. It was held that the purchaser had been subrogated to the benefit of the first mortgage. Quite aside from the purchaser's mistake, induced by fraudulent misrepresentations by his vendor, since the purchaser had not undertaken to pay off the second mortgage, there was no reason why he should not have been allowed to set it up against the assignee of the second mortgage.[77]

11.6.b Purchasers who have not assumed the payment of an incumbrance

The purchaser may purchase the incumbered property from the vendor *without* covenanting to pay off the incumbrances. He is sometimes said to have purchased the mere equity of redemption. In such a case, the policy reasons which militated against allowing the purchaser in the last category to claim the benefit of incumbrances which he has paid off do not apply. Sheldon[78] stated that

> "The rule that the payment of a mortgage-debt by the owner of the equity of redemption will extinguish the mortgage does not apply to the payment of an incumbrance which existed before the conveyance to the owner of the equity, and which the latter is under no obligation to pay."[79]

Roman law acknowledged a right of subrogation for a purchaser of mortgaged property who used part of the purchase price to pay off incumbrancers. This applied even though, in a sense, the result was that the purchaser acquired a mortgage over his own property, which would normally offend a general principle of Roman law.[80]

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[76] See sections 6.1 and 6.2.c, *ante*.

[77] See the next section. See also *In re Hubbard* 89 B.R. 920, 923 (Bkrtcy. N.D. Ala. 1988), referring to *Restatement of the Law, 2d, Restitution* (tentative draft #2), April 6, 1984, section 31f, at 36:

> "The case may be one in which property burdened with two liens is sold for new value, and the purchaser discharges the senior lien without knowledge of the junior one, and the latter is not divested by the sale... In either case, absent a remedy for the transferee, the junior lienholder would be unjustly enriched by the advancement of his lien.
> "In these circumstances the transferee's lack of care to discover the existence of the junior lien, by consulting public records or otherwise, is not alone a reason to withhold subrogation."

[78] H.N. Sheldon, *The Law of Subrogation* (2nd ed., 1893), § 28.

[79] See also *Ryer* v. *Gass*, 130 Mass. 227 (1881); G.E. Harris, *op. cit.*, § 85; *Watson* v. *Gardner*, 119 Ill. 312, 320; 10 N.E. 192, 198 (1887), in which the court relied on, *inter alia*, the same section of the first (1882) edition of Sheldon.

[80] This was a species of the "*successio in locum*" (on which, see *ante*). See J. Mestre, *La Subrogation Personnelle* (1979), § 16. Modern French law grants a purchaser, who will not be considered as personally liable to the mortgagees, a right of subrogation to their rights on payment to them: Mestre, *op. cit.*, §§ 93-95. Mestre notes that an apparent objection to this form of subrogation was that the purchaser

It may be possible to say that generally, in cases where the purchaser pays off incumbrances which he has not covenanted to pay, he should be held entitled to stand in the position of the creditor on the ground that his payment has preserved his own property interest, by reducing the risk of sale by the creditor.[81]

One early English case seems to contradict the rule stated here. In *Toulmin* v. *Steere*,[82] a prior incumbrance had been paid off by a subsequent incumbrancer, who later assigned his interest to the purchaser of the equity of redemption. Sir William Grant M.R. held that the prior incumbrance had merged in the equity of redemption, and thus no longer subsisted in the hands of the purchaser. The judge did not apprehend any distinction between the situations where the purchaser assumed payment of the incumbrance, and where he did not.

Later cases have distinguished this case almost to the point of vanishing. Thus, in *Whiteley* v. *Delaney*,[83] Viscount Haldane L.C. said

> "Indeed, it is now quite plain that a purchaser from a mortgagor and the first mortgagee can always, if he chooses, keep the first mortgage alive, and so protect himself against subsequent incumbrances, whether he had notice of them or not."[84]

In the Irish case of *Unthank* v. *Gabbett*,[85] a purchaser bought land subject to a prior charge and a subsequent annuity. He paid off the charge, and was held to be entitled to the benefit of it. No merger

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had "paid his own debt": he pays by a delegation, into the hands of the mortgagees rather than into the hands of the vendor. Nonetheless, Article 1251-2° of the Civil Code provided that "subrogation takes place by operation of law ... to the benefit of the purchaser of property who uses the purchase price for the payment of creditors to whom the property is mortgaged." It appears, however, rather paradoxically to be the case that the subrogation is only deemed to take effect if an attempt is made by a subsequent incumbrancer to evict the purchaser or to realise a mortgage: *op. cit.*, § 94.

[81] Sheldon, *loc cit.*, citing *Walker* v. *King*, 45 Vt. 525 (1873) (see *post*). Note, however, that Sheldon seems to regard this case as one of compulsion: he refers to "the principle that where one who is not personally liable for a debt secured by a mortgage or other lien is compelled to pay it in order to preserve his own property, and does pay it, he may be subrogated to the lien, though, if he takes an assignment of it, this of course will only strengthen his position" (citations omitted). In *Wilson* v. *Kimble*, discussed at section 11.6.a, *supra*, the court relied in part on *Towle* v. *Hoit*, 14 N.H. 61 (1843), in which it was held that one who had paid off a mortgage, in order to protect his interest in the land, which might otherwise have been defeated, was subrogated to the position of the mortgagee, even though the mortgage had been regularly discharged. *Cf. Malireddi Ayyareddi* v. *Gopalakrishnaya* (1923) L.R. 51 Ind. App. 140. Note also Harris, *op. cit.*, §§ 644-646, treating cases of purchasers of incumbered estates under the rubric of parties paying a debt to protect their own interest.

[82] (1817) 3 Mer. 210.

[83] [1914] A.C. 132.

[84] At 145. In *Watts* v. *Symes* (1851) 1 De G., M. & G. 240, Knight Bruce L.J. said (at 244) that *Toulmin* v. *Steere* carried the rule that a mortgagor could not set up his own indebtedness against his creditor too far by extending it to the case of the purchaser of the mere equity of redemption.

occurred. Sir Anthony Hart L.C. said that the purchaser had merely bought subject to the charge; he had not assumed to pay it as a part of the purchase price.[86]

As has been seen, it is frequently stated that where one with an interest in property, whether as purchaser of the equity of redemption, or in some other capacity, pays off a charge, the consequences of the payment depend on his intention.[87] Furthermore, where his intention is not clear, he will be presumed to have followed his own best pecuniary interest, and to have intended to have kept the charge subsisting. It was expressed thus by Lord Macnaghten in *Thorne* v. *Cann*:[88]

> "Nothing, I think, is better settled than this, that when the purchaser of an estate pays charges on the estate which he is not personally liable to pay, the question whether those charges are to be considered as extinguished or as kept alive for his benefit is simply a question of intention. You may find the intention in the deed, or you may find it in the circumstances attending the transaction, or you may presume an intention from considering whether it is or is not for his benefit that the charge should be kept on foot."[89]

In *Walker* v. *King*,[90] the purchaser of an equity of redemption had paid off two mortgages, and a portion of a third. The remainder of the third mortgage had been paid off by another party. It was held that the purchaser was subrogated to the rights of the mortgagees, to the amount he had paid them. The purchaser was held to have priority over a fourth mortgagee for the amount he had so paid, and also for

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[85] (1830) Beatty 453.

[86] If he had, on payment of the debt secured by the charge, the charge should have merged in the equity of redemption, and the annuitant should have advanced in priority; see the preceding section.

[87] See section 11.4.a, *ante*.

[88] [1895] A.C. 11.

[89] At 18-9. In that case, the mortgage had actually been assigned to the purchaser. Thus, the intention was not greatly in doubt. An assignment is not necessary in order to keep a charge alive, as is clear from his lordship's words. See also *Robinson* v. *Leavitt*, 7 N.H. 73, 99 (1834) *per* Parker J.; *Bell* v. *Woodward*, 34 N.H. 90 (1856); *Gannett* v. *Blodgett*, 39 N.H. 150, 153 (1859); *Aiken* v. *Gale*, 37 N.H. 501 (1859); *Hinds* v. *Ballou*, 44 N.H. 619 (1863); Sheldon, *op. cit.*, §§ 13, 28-37. In *Ryer* v. *Gass*, 130 Mass. 227 (1881), the owner of the equity of redemption was under no obligation to pay either of two mortgages on the land. He paid off the first one, and took an assignment of the mortgage to a third party in trust for himself. It was held, unsurprisingly, that the mortgage had not merged in the equity of redemption. Ames J. stated that

> "even without any written assignment, a payment of the entire mortgage debt may give to the party making the payment the rights of an equitable mortgagee, so that in some circumstances he may be subrogated to the position of the mortgagee. Whether a payment of the entire amount due shall operate as a discharge of the debt, or as a purchase and assignment of the mortgage, depends not so much on the form of words used, as upon the relations subsisting between the party advancing the money, and the party executing the release or transfer, and their relative duties."

See also *Millspaugh* v. *McBride*, 7 Paige Ch. 509 (N.Y. 1839) and *Skeel* v. *Spraker*, 8 Paige Ch. 182, 196 (N.Y. 1840).

[90] 45 Vt. 525 (1873).

interest on that amount, according to the terms of the mortgages. Wheeler J. noted that if the fourth mortgagee were allowed to redeem the first three mortgages on payment merely of what the purchaser had paid in respect of them, this would put all risk of a fall in the value of the land on the purchaser, and would allow the fourth mortgagee to await an increase in the value of the land in order to improve his security. Such a result would be unjust. The purchaser was therefore entitled to avail of the interest terms of the mortgages.[91]

In a series of Indian appeals, the Privy Council expressed disapproval of *Toulmin* v. *Steere.* In *Gokuldoss Gopaldoss* v. *Rambux Seochand*,[92] the Judicial Committee held that the purchaser of the equity, who had paid off a prior mortgage, which he had not undertaken to pay, was entitled to stand in the place of the prior mortgagee against subsequent incumbrancers. Sir Richard Couch stated:[93]

> "The obvious question to ask in the interests of justice, equity, and good conscience, is, what was the intention of the party paying off the charge? He had a right to extinguish it and a right to keep it alive. What was his intention? If there is no express evidence of it, what intention should be ascribed to him? The ordinary rule is that a man having a right to act in either of two ways, shall be assumed to have acted according to his interest."

This assumption led to the conclusion that the prior mortgage had been kept alive by the purchaser for his own benefit.[94]

In *Malireddi Ayyareddi* v. *Gopalakrishnaya*,[95] land was subject to three mortgages, the second of which also covered crops. The purchaser of the equity of redemption paid off the second mortgage, partly in order to prevent a sale of the crops. The Privy Council held that he was entitled to priority over the third mortgagee for the entire amount which he had so paid.[96] Lord Phillimore stated[97] that

> "[i]t is now settled law that where in India there are several mortgages on a property, the owner of the property subject to the mortgages may, if he pays off an earlier charge, treat himself as buying it and stand in the same position as his vendor, or to put it another way, he may keep the incumbrance alive for his benefit and thus come in before a later mortgagee. This rule would not

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[91] See Harris, *op. cit.*, § 644, to the same effect.
[92] (1884) L.R. 11 Ind. App. 126.
[93] At 133-4.
[94] See also *Dinobundu Shaw Chowdhry* v. *Jogmaya Dasi* (1907) L.R. 29 Ind. App. 9; *Mahomed Ibrahim Hossein Khan* v. *Amrika Pershad Singh* (1911) L.R. 39 Ind. App. 68.
[95] (1923) L.R. 51 Ind. App. 140.
[96] The argument had been made on behalf of the third mortgagee that the second mortgage should have been regarded as discharged, as the purchaser's payment had been directed towards saving the crops.
[97] At 143.

apply if the owner of the property had covenanted to pay the later mortgage debt, but in this case there was no such personal covenant."

11.7 Subrogation of Purchaser where Vendor covenanted to indemnify him

Where the vendor expressly covenanted to indemnify the purchaser, the purchaser will be subrogated to the creditor's rights against the vendor if he is forced to pay. This is the converse of the situation described in a previous section. The situation is analogous to suretyship, with the purchaser as the surety and the vendor as the principal debtor. In *The Executors of Fergus* v. *Gore*,[98] the late Earl of Arran had settled upon his son, the present earl, certain estates. The late earl expressly covenanted in the deed of settlement that he would indemnify the settled estates from incumbrances. By his will, the late earl devised his unsettled estates to the defendant, Gore. He charged the debts affecting the settled estate on the lands he so devised. After the death of the late earl, the present earl had been forced to pay several judgment debts with the interest thereon, contrary to the covenant in the deed of settlement. He now prayed to recover the amounts so paid from the estate devised to Gore.

Lord Redesdale L.C. decreed that the present earl was entitled to that sum. The order made by the court was, in relevant part, as follows:-

> "... Declare [the present earl] entitled to stand in the place of the judgment creditors whose debts he has been forced to discharge..."[99]

Thus, it will be seen that the grantee of lands, who was in the position of a purchaser, albeit for no consideration, was held subrogated to the rights of creditors whom he had been forced to pay, against the person who should in equity have paid the debts.[100]

In *Rotherham* v. *Flynn*,[101] a judgment debtor had conveyed land to the plaintiff, covenanting against incumbrances. The judgment creditor later brought proceedings on his judgment. The plaintiff

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[98] (1803) 1 Sch. & Lef. 107.
[99] (1803) 1 Sch. & Lef. 107, 110.
[100] In *Garnett* v. *Armstrong* (1843) 5 Ir. Eq. R. 533, an estate had been sold subject to a judgment, but the vendor covenanted to indemnify the purchaser against incumbrances, not excepting the judgment. Sir Edward Sugden L.C. held (at 538) that the effect of the deed was "that as between the purchaser and the judgment creditor the estate was to be subject to it; but at the same time the sellers agreed to indemnify the purchaser, and to throw it on the other assets of the testator, at the same time stipulating that the purchaser was to be subject to the claims of the judgment creditor." The head-note of the report states that the judgment creditor was held entitled to a sale of the lands conveyed subject to the judgment. This is undoubtedly correct. It then states that the purchaser was held entitled to be repaid the amount of the judgment out of the other assets of the vendor subject to the judgment. While this is consistent with Sir Edward Sugden's quoted comment, it does not appear in the body of the report.
[101] (1816) Beatty 555.

came to an arrangement with the judgment creditor, under which he paid the creditor in part. He then offered to pay the remainder of the judgment if the creditor would thereupon assign the judgment to him, or to a trustee for him. The creditor refused to do this, although he was willing to discharge the judgment if the plaintiff paid him. His motive for refusing an assignment was that he had later judgments against the debtor, which bound his other estate, and he did not want the plaintiff to claim on the prior judgment, which would have the effect of depleting the debtor's estate. The plaintiff brought these proceedings, seeking a declaration that upon payment, he would be entitled to an assignment of the judgment.

Counsel for the plaintiff argued that the plaintiff was in a situation analogous to that of a surety, with the original debtor the principal debtor. He should therefore be entitled upon payment to an assignment of the creditor's securities. Counsel for the judgment creditor argued that the judgment would be extinguished upon payment, and that therefore, the plaintiff could not insist on an assignment, which would be pointless.[102] The plaintiff's only recourse would be against the debtor, on his covenant. It was also argued that even if the plaintiff had a right to an assignment, on the basis of the debtor's covenant, that could not operate to the detriment of the creditor, who was not a party to it. Lord Manners L.C. stated:

> "I cannot, I confess, discover how this case can be taken out of the common rule of this Court, that when one person pays off the debt of another, he is entitled to an assignment of the security originally passed for the debt."[103]

He stated that if the judgment debtor himself had paid the judgment, he could have demanded an assignment to a trustee for himself to protect himself against subsequent incumbrances. This appears to be somewhat questionable in view of later authority to the effect that a debtor cannot claim subrogation to an incumbrance on his own estate to the detriment of a later creditor of his own.[104]

Nonetheless, the decision that the plaintiff was entitled to an assignment of the security upon paying it is in accordance with principle. The Chancellor did express some doubt as to whether the plaintiff could recover upon the judgment against the debtor. He indicated that if the process of execution had been completed upon the judgment, it would have been impossible for the plaintiff to have recovered

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[102] (1816) Beatty 555, 559. Reference was made to decisions such as *Woffington* v. *Sparks* (1754) 2 Ves. Sen. 569, in which it was held that sureties were not entitled to an assignment of bonds or judgments, on the grounds that those securities were discharged upon payment, and that an assignment would be nugatory. See section 7.4.a, *ante*.

[103] (1816) Beatty 555, 558.

[104] *Ryer* v. *Gass*, 130 Mass. 227, 229 (1881); *Malireddi Ayyareddi* v. *Gopalakrishnaya* (1923) L.R. 51 Ind. App. 140, 143; *Platt* v. *Mendel* (1884) 27 Ch. D. 246; *Watts* v. *Symes* (1851) 1 De G., M. & G. 240, 244; *Otter* v. *Lord Vaux* (1856) 6 De G., M. & G. 638; *Parkash* v. *Irani Finance Ltd.* [1970] Ch. 101; Sutton, *op. cit.*, 84.

from the debtor. However, in this case, that stage had not been reached.[105] He therefore decreed that upon payment, the plaintiff would be entitled to an assignment.[106]

Where the purchaser pays the full value of the land to the vendor, including the value of incumbrances, and he later pays off an incumbrance to protect his interest in the lands, he is entitled to an assignment of it to enforce it against the vendor.[107] This applies equally to subsequent purchasers.[108]

11.8 The Subrogation of Purchasers under a Void Sale

Where a purchaser acquires *no* interest under a sale, he may claim recovery of the purchase price from the vendor, on the ground that the consideration has totally failed. While at one time, he might have been regarded as entitled to claim to have retained property in the sum which he had paid, and to be entitled to claim a proprietary interest in any traceable proceeds of the money, by analogy with *Sinclair* v. *Brougham*,[109] it now seems that such a right will not be recognised.[110] There is considerable, though scattered, authority in favour of the grant of a lien or the recognition of subrogation in these circumstances. It would appear difficult to explain these decisions on Birks' proprietary base theory. However, it is felt that it is justifiable either to hold the purchaser to have been subrogated to the rights of incumbrancers whose liens he has discharged, or alternatively to impose a lien on the property to the amount of charges incurred in maintaining it, because the purchaser *ex hypothesi* intended to obtain the property, and expended sums in the belief that he was the owner. On a restitutionary analysis, possible unjust factors are total failure of consideration and mistake. It does not appear that the purchaser has any

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[105] An *elegit* had issued upon the judgment. However, no return had been filed. This apparently left it still doubtful whether the plaintiff could "re-use" the judgment by issuing a fresh execution upon it. This, however, would be a question for a court of law to decide. If it were clearly impossible for the plaintiff to recover, an assignment would not have been decreed.

[106] However, since it was not clear that the plaintiff could successfully utilise the judgment, he declined to award costs. One should also note the case of *Schryver* v. *Teller*, 9 Paige Ch. 173 (N.Y. 1841), where Walworth C. said (at 176) that if a mortgagor mortgaged one parcel of his estate which was subject to judgments, and the judgment creditors enforced payment from the mortgaged estate, the mortgagee would be entitled to an assignment of the judgments in order to reimburse himself from the residue of the estate retained by the mortgagor. While it is not so stated in the judgment, the mortgage seems to have contained a covenant against incumbrances. In *Fletcher* v. *Chase*, 16 N.H. 38 (1844), there had been a sale with a covenant against incumbrances, and it was held that, upon paying the prior mortgagee, the purchaser would have been subrogated to his rights in order to indemnify himself. In *Moore* v. *Gillingham*, 22 Wash. 2d 655; 157 P. 2d 598 (1945), a vendor had conveyed, covenanting against incumbrances. At the time, unpaid taxes were a lien on the property. The purchaser sold the benefit of his contract of purchase on to a sub-purchaser, guaranteeing the payment of the taxes, and then paying the taxes. It was held that the purchaser was not a volunteer when he paid the taxes. Both statute and common law provided a remedy for him against the vendor, and he was awarded damages against the vendor. However, he was not granted a lien, as the vendor retained no interest in the property, which had come into the hands of the sub-purchaser.

[107] *Wadsworth* v. *Lyon*, 93 N.Y. 201, 214 (1883).

[108] *Wadsworth* v. *Lyon*, 93 N.Y. 201, 214 (1883).

[109] [1914] A.C. 398.

right to recover the sums paid from the incumbrancer, as that party has given consideration for the payment in the discharge of the debt, and for the same reason, has changed his position on the strength of the payment.[111]

Thus, in *Scott* v. *Dunn*,[112] it was held that in so far as the purchase price of land purportedly sold under a void executor's sale had been applied in payment of the debts of the deceased's estate, the purchasers could claim to have been subrogated to the rights of those creditors. Gaston J. stated that the case was analogous to one of a surety, who could claim to be subrogated to all the rights of the creditor against the principal debtor.[113] In *Bright* v. *Boyd*,[114] a purchaser under a void sale had expended money in making improvements to the property, and in paying off claims against the property. Story J. held that he was entitled to compensation for these payments. Story J. stated:

> "There is still another principle of the Roman law which is applicable to the present case. It is that where a *bona fide* possessor or purchaser of real estate pays money to discharge any existing incumbrance or charge upon the estate, having no notice of any infirmity in his title, he is entitled to be repaid the amount of such payment by the true owner, seeking to recover the estate from him."

Since the estate had been relieved from charges which had previously burdened it, he held that it should be treated as charged to an equivalent amount in favour of the purchaser.

This decision was followed in later cases. In *Vallé* v. *Fleming*,[115] Napton J. stated that "whether this equity be administered under the name of compensation, or by substituting the purchaser in the place of the creditors, whose debts he has paid, or by giving him the benefit of the mortgage which his money has paid off, is not material."[116] Similarly, in the later case of *Milburn* v. *Phillips*,[117] a purchaser under a void execution sale was held to have been subrogated to the rights of the holders of liens on the property, who had been paid off using the purchase price. Jordan J. stated:

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[110] *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council* [1996] A.C. 669.
[111] *Aiken* v. *Short* (1856) 1 H. & N. 210. See also *Barclays Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677, 687.
[112] 1 Dev. & Bat. Eq. 425; 30 Am. Dec. 174 (N.C. 1836).
[113] He added (30 Am. Dec. 174, 176) that the principle involved "when traced to its origin, is founded on the plain obligations of humanity, which bind every one to furnish those aids to escape from loss which he can part with without injury to himself."
[114] 1 Story 494 (1841).
[115] 29 Mo. 152 (1859).
[116] *Bright* v. *Boyd* was also followed in *Blodgett* v. *Hitt*, 29 Wis. 169 (1871), *Union Hall Association* v. *Morrison*, 39 Md. 281 (1873) and *Bailey* v. *Bailey*, 41 S.C. 337; 44 Am. St. Rep. 713 (1894).
[117] 143 Ind. 93; 52 Am. St. Rep. 403 (1895).

"Under such circumstances, equity generally treats the encumbrance as still subsisting so long as necessary to protect the rights of the party paying it off, and this right cannot be affected by the fact that appellees' title proved to be invalid, when the payment was made in the good faith belief that they were the owners of the land."[118]

Furthermore, if the purchaser makes payments in the belief that he was liable for them as owner of the property, it appears that he will be granted a lien in respect of those payments. In Ireland, a purchaser of an insurance policy has been granted a "salvage lien" in respect of premiums which he believed himself liable to pay, even though the sale was void and he had in fact obtained no interest.[119] Sheldon stated that:

"One who in good faith, believing himself to have an interest in property which is subject to a lien, pays off the lien to protect that interest, will in equity be subrogated for his reimbursement to the protection of that lien, as against the real owner of the property, who has stood by in silence while the payment was made."[120]

In *West* v. *Reid*,[121] an assignee under a void assignment was held entitled to the repayment by the assignor's estate of premiums which he had paid. In *Saunders* v. *Dunman*,[122] Fry J. stated that the

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[118] 143 Ind. 93, 97; 52 Am. St. Rep. 403, 406 (1895). The author of the Annotation, "Rights of Purchasers Who, by Reason of Void Sales, have Paid off Claims on Real Estate," 30 Am. Dec. 177, on this series of cases offered the view that the purchaser's right could not be one of subrogation. The reason given was that the purchaser did not pay under legal compulsion; rather, he was a volunteer. Whether or not this was true at the time at which the author wrote, has been comfortably established that purchasers, lenders, and others who cannot strictly be said to have paid under compulsion, may be subrogated. This argument is not, therefore, convincing. The same author then goes on to refer these decisions to the principle that no one should be enriched through a wrong done to another.

[119] *In re Sargent's Trusts* (1879) 7 L.R. Ir. 66. In *In re Niland*, 50 B.R. 468 (Bankr. Tex. 1985), appeal denied 809 F. 2d 272 (1987), rehearing granted, opinion withdrawn 825 F. 2d 801, a foreclosure sale was held to have been partially invalid. As subrogation to the lien on which the decree for foreclosure was obtained would have been pointless (the lien being invalid in part), the court *imposed* an equitable lien in favour of the purchaser.

[120] *Op. cit.*, § 9. See also *In re Pride; Shackell* v. *Colnett* [1891] 2 Ch. 135; *Fowler* v. *Parsons*, 143 Mass. 401; 9 N.E. 799 (1887) (if the owners of goods knowingly permitted one who believed himself to be the owner to pay import duties on the goods, the payer would have an equitable lien on the goods to the amount of the duty which he had paid). In *Charles H. Dauchy Co., Inc.* v. *Wilkinson*, 251 App. Div. 53; 295 N.Y.S. 666 (1937), a purchaser purported to buy merchandise at a void execution sale. The purchaser alleged that the sheriff had misrepresented that he was selling the merchandise in his official capacity free from liens. The purchase price was applied to the discharge of judgment liens on the merchandise. The sale was impeached by other creditors of the seller as a fraudulent conveyance. It was held that the purchaser had not been subrogated to the rights of the former lien-holders, it being thought that subrogation could only be available to (a) persons who paid, being under an obligation to do so, (b) persons who paid in order to protect a right belonging to them, or (c) persons whose property had been misappropriated and applied in the payment of a debt.

[121] (1843) 2 Hare 249.

[122] (1878) 7 Ch. D. 825.

question of the assignor's right to a lien had not been really decided in that case. A commentator[123] noted that this was "merely, however, because it was thought too clear for argument." In *Ahmed* v. *Kendrick*,[124] Nicholls L.J. stated that a purchaser under a partially invalid sale whose funds were applied in paying off an incumbrance on the land, would be subrogated to the position of the incumbrancer.[125]

By contrast, however, in *Falcke* v. *Scottish Imperial Insurance Company*,[126] the payer owned the equity of redemption of a policy, though he was no longer liable to pay the mortgage debt. He mistakenly believed that he had a contract for purchase of the mortgagee's interest. On the faith of that belief, he paid a premium. It was held that he had acquired no lien on the proceeds of the policy through his payment. It is felt that the decision was wrong, and that he should have been held entitled to a lien on the ground either that he had made a payment under a mistaken belief, and that it would be unjust to allow the mortgagee to obtain the benefit of that payment, or that his payment had served to "save" the policy.

11.8.a Case of a Transferee under a Transfer which was set aside as an unconscionable bargain

In the recent Northern Irish case of *Stronge* v. *Johnston*,[127] Girvan J. set aside a transfer of land on the ground that it was an unconscionable bargain. The transferee had paid off a mortgage on the land. Girvan J. stated that the transferor, in seeking equity by seeking to have the transaction set aside, had to do equity, by reimbursing the transferee the sum which he had paid to the mortgagee. He therefore held that the transferee had been subrogated to the position of the mortgagee.[128]

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[123] The author of "Insurance Premiums and the Doctrine of Salvage," (1887) 31 S.J. 344.
[124] [1988] 2 F.L.R. 22, 33.
[125] See also *Penn* v. *Bristol and West Building Society* [1995] 2 F.L.R. 938.
[126] (1886) 34 Ch. D. 234.
[127] Unreported, High Court, Chancery Division, Girvan J., 16th April 1997, 1996 No. 1534, discussed by Capper, "The Debtor, the Wife, the Farm and the Opportunist," (1997) 48 N.I.L.Q. 400.
[128] He stated that "[h]e who discharges another's secured obligation, wholly or in part, is entitled to be repaid out of the security the amount of the sum or sums paid by him." This seems over-broad. The decision in the case is nonetheless justifiable by analogy with the cases of payments by purchasers under void sales.

CHAPTER 12

MARSHALLING OF SECURITIES

12.1 Introduction

Marshalling is best explained by an example. A. is the holder of a prior security over two funds, which will be called Blackacre and Whiteacre, each belonging to the same debtor. B. has a subsequent security over Blackacre, but not Whiteacre. Blackacre is not an adequate security to pay A. and B. Therefore, if A. realises his security out of Blackacre, B. will be left unpaid. Because equity does not care to leave it in the power of a prior creditor to decide if subsequent creditors will be paid or not, it arranges or marshals the claims on Blackacre and Whiteacre so that both A. and B. are paid, so far as may be done without prejudicing A.'s security. Where A. has already realised his security out of Blackacre, B. will be held to have been subrogated to A.'s rights over Whiteacre, so as to enable him to recover his debt in the manner which was open to A.

Marshalling is an ancient jurisdiction. Analogies have sometimes been drawn with suretyship.[1] Story, who drew such an analogy, also claimed that it operated so as to prevent an unjust enrichment.[2] The factor which renders it just to allow marshalling is still elusive. Mitchell suggests, in a rather off-hand manner, that it may be a failure of the consideration for which the second creditor had contracted.[3] The second creditor may, however, have been fully aware that his security would be a subsequent one and therefore vulnerable. If that is so, he would have received precisely the consideration for which he had contracted. It is, of course, possible that the second creditor might be deemed to have advanced funds in the belief that the securities given by the debtor would be marshalled to his benefit, if possible.[4] Mitchell also omits consideration of marshalling of assets, *i.e.*, cases of marshalling applied to claims in the administration of an estate. Failure of consideration hardly seems an appropriate explanation in such a case. It seems preferable to say that equity observes a policy of ensuring that secured creditors or claimants in the administration of an estate should, so far as possible, be paid their demands, even at the expense of unsecured creditors or other claimants who are not the object of a testator's favour.

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[1] Story, *Commentaries on Equity Jurisprudence* (13th ed., M.M. Bigelow, 1886), § 636; Henry Home, Lord Kames, *Principles of Equity* (1760), 15.
[2] *Op. cit.*, §§ 558, 567; J. Fonblanque, *A Treatise of Equity* (5th ed., 1820), 298.
[3] *Op. cit.*, 143.
[4] J.D. Heydon, W.M.C. Gummow and R.P. Austin, *Cases and Materials on Equity and Trusts* (4th ed., 1993), observe (at § 1608) that it is not "settled whether marshalling has its foundation in any doctrine of equity governing generally the conduct of the two fund-holders." One is tempted to echo the reputed comment of Chou En Lai on the effects of the French Revolution: after (in this case) three centuries of reported cases, it is still too early to say.

One view holds that B. has a form of proprietary interest in Whiteacre, over which A. alone has security. On this view, if A. realised both Blackacre and Whiteacre, and the proceeds of realisation of the two exceeded the amount of his claim, he would hold the surplus subject to a trust or lien in favour of B.[5] In *Lawrence* v. *Galsworthy*,[6] it was held that B. was entitled to have a fraudulent sale of Whiteacre by A. set aside. A. had sold Blackacre and realised a sum in excess of his claim. He then put Whiteacre up for sale, and sold it to his solicitor's clerk, at a considerable under-value. B. claimed that the sale of Whiteacre was fraudulent and invalid, and that A. should account to him for the value of Whiteacre. Stuart V.-C. appeared to suggest that B. had some sort of right *in rem* against Whiteacre. He stated that it appeared that B. had, "upon an equitable doctrine of this Court, an indirect interest in [Whiteacre] which would entitle him to maintain a suit, and to question the validity of the sale by which [Whiteacre] had been dealt with."[7]

Dixon took the opposite view:

> "[The equity to have securities marshalled] is merely a rule of the court of chancery for arranging existing assets and securities which remain undisposed of, with a view to the equal advantage of all at the time when proceedings are commenced for marshalling. The right of marshalling does not constitute a lien upon the land which follows it into the hands of a purchaser, with or without notice."[8]

There seems to be far more support for this view.[9] However, even if this is so, it does not mean that B. can have no remedy if A. releases Whiteacre from his charge. While the Supreme Court of Tasmania held in the *Commonwealth Trading Bank*[10] case that B. had no recourse against A. in those

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[5] See Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed., 1992), § 1104.
[6] (1857) 3 Jur. (n.s.) 1049. "Blackacre" was goods. "Whiteacre" was an insurance policy.
[7] (1857) 3 Jur. (n.s.) 1049, 1050.
[8] Dixon, *op. cit.*, 107. In *Jackson* v. *Finance Corporation of Washington*, 41 F. 2d 103, 106; 59 App. D.C. 309 (1930), the court quoted with approval Pomeroy, *Equity Jurisprudence*, VI, para. 870, to the effect that the right to have securities marshalled was not a lien, but neither was it a mere "incident to the remedy ... [t]he right is not generally enforced by an independent action, but it exists and may be asserted whenever an opportunity is afforded." In *Fidelity & Casualty Company of New York* v. *Massachusetts Mutual Life Insurance Co.*, 74 F. 2d 881, 884; 35-1 U.S. Tax Cas. (C.C.H.) P9298; 14 A.F.T.R. (P-H) 940 (4th Cir. 1935), Parker J., on behalf of the court, stated that the right to marshal was a "mere inchoate equity subject to displacement," until such time as it was exercised. However, the court also held that where A. waived its rights to Whiteacre, it was precluded from asserting its rights on Blackacre in priority to B. to the extent of the value of A.'s former rights over Whiteacre.
[9] *Barnes* v. *Racster* (1842) 1 Younge & Coll. C.C. 401, 410; *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.* [1970] Tas. S.R. 120; *Sarge Pty. Ltd.* v. *Cazihaven Homes Pty. Ltd.* (1994) 34 N.S.W.L.R. 658; Meagher, Gummow and Lehane, *loc. cit.*; Cleaver, "Marshalling," (1991) 21 V.U.W.L.R. 275, 278.
[10] [1970] Tas. S.R. 120.

circumstances, American courts have taken a very different view.[11] The position in America is that Whiteacre is regarded as *primarily* liable to A. for payment of his claim.[12] If he releases Whiteacre, or wastes or misapplies it, his claim on Blackacre is postponed to that claim of B., to the extent of the value of Whiteacre.[13] In other words, the rule in cases of suretyship or insurance is extended to the present situation: if a creditor has made it impossible for another party to be subrogated to the creditor's former rights upon payment (or suffering execution or realisation upon his fund), then he is released from his obligation. In the present context, this solution is achieved by advancing B. over A. on Blackacre.[14] A. will not be so affected unless he has notice of B.'s interest.[15]

12.2 Requirements for Marshalling

The following are the necessary preconditions for the availability of marshalling:

(i) A Common Debtor

In order for marshalling to be available, Blackacre and Whiteacre must belong to the same debtor.[16] In *The "Chioggia"*,[17] A., the holder of a bottomry bond had a lien on the ship and freight

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[11] Note also *Manks* v. *Whiteley* [1911] 2 Ch. 448, 466 and *In re Bank of Credit and Commerce International S.A. (No. 8)* [1995] Ch. 46, affirmed [1996] Ch. 245, affirmed [1997] 4 All E.R. 568.

[12] See, *e.g.*, *Eddy* v. *Traver*, 6 Paige Ch. 521, 525 (N.Y. 1837) *per* Walworth C.

[13] Sheldon, *op. cit.*, § 72, citing, *inter alia*, *Hazard* v. *Fiske*, 83 N.Y. 287 (1881). See also *Jones* v. *Myrick's Executors*, 49 Va. (8 Gratt.) 179, 218 (1851). Later American cases seem to require actual rather than constructive notice before A. can be so bound: *Burnham* v. *Citizens' Bank of Emporia*, 40 P. 912 (Kan. 1895), *Fidelity & Casualty Company of New York* v. *Massachusetts Mutual Life Insurance Co.*, 74 F. 2d 881, 883; 35-1 U.S. Tax Cas. (C.C.H.) P9298; 14 A.F.T.R. (P-H) 940 (4th Cir. 1935).

[14] See *Cheesebrough* v. *Millard*, 1 Johns. Ch. 409 (N.Y. 1815); *Guion* v. *Knapp*, 6 Paige Ch. 35 (N.Y. 1836); *Patty* v. *Pease*, 8 Paige Ch. 277 (N.Y. 1840); *Brown* v. *Simons*, 44 N.H. 475, 482 (1863).

[15] See Sheldon, *op. cit.*, § 73. A. will only be affected in this way if his right against Whiteacre was clear and effective: *ibid.*, citing *J.S. Kidder & Co.* v. *Page*, 48 N.H. 380 (1869) (settlement by A. of a suit in respect of his entitlement to Whiteacre held not to cause forfeiture of his rights over Blackacre, which would only occur if A. had wilfully inflicted a loss on B.); *Brown* v. *South Boston Savings Bank*, 148 Mass. 300 (1888). See also Story, *op. cit.*, § 633, note (b); *Burnham* v. *Citizens' Bank of Emporia*, 40 P. 912 (Kan. 1895); *Jackson* v. *Finance Corporation of Washington*, 41 F. 2d 103, 106; 59 App. D.C. 309 (1930); *Fidelity & Casualty Company of New York* v. *Massachusetts Mutual Life Insurance Co.*, 74 F. 2d 881, 883; 35-1 U.S. Tax Cas. (C.C.H.) P9298; 14 A.F.T.R. (P-H) 940 (4th Cir. 1935). See also the Irish case *Ryan* v. *Cambie* (1845) 9 Ir. Eq. R. 378.

[16] Story, *op. cit.*, § 634, quoted by Porter M.R. in *McCarthy* v. *McCartie (No. 2)* [1904] 1 I.R. 100, 107. In *In re Bank of Credit and Commerce International (No. 8)* [1996] Ch. 245, 271 (affirming [1995] Ch. 46), Rose L.J. said that "[f]or the doctrine to apply there must be two debts owed by the same debtor to two different creditors." In that case, there were two debtors (a principal debtor and a depositor whose account balance had been charged to the creditor) in respect of a single debt to the same creditor. Even if the depositor (who was in essence a surety) had paid the debt (or had his balance set off against the debt), his right to be indemnified by the principal debtor would nonetheless be in respect of the same debt as that for which the principal had been liable to the creditor. Lord Hoffmann agreed with this in the House of Lords: [1997] 4 All E.R. 568, 581.

[17] [1898] P. 1.

("Blackacre") and also on cargo, which belonged to a third party ("Whiteacre"). B., a supplier of necessaries, had a lien only on the ship and freight ("Blackacre"). However, Gorell Barnes J. refused to allow B. to marshal A.'s claim onto the cargo, as the cargo was owned by the third party. A. therefore had in effect two debtors, B. only one.[18]

The requirement has notable effect in cases of joint debtors. So, in a case where one debtor mortgages Blackacre to A., then that debtor *and another* mortgage Whiteacre to A., and finally, the first debtor mortgages Blackacre again to B., B. can have no recourse by subrogation to Whiteacre: as far as A. is concerned, he has two debtors, and must recover his proper claim from each.[19] Sheldon explains the basis for this rule as being that "equity will not sanction a principle which, though it may be just as to the creditors, is unjust as to the debtors."[20] So, in *Ex parte Kendall*,[21] a creditor of a group of four debtors could not compel a creditor of the four of them and one other to prove first against that other.[22]

It would be otherwise if it could be shown that as between the two debtors, he whose fund (Whiteacre) was bound once was obliged to bear the ultimate incidence of the debt for which their estates were bound in common.[23]

(ii) Equal Recourse to each Fund

Further, as regards A., both Blackacre and Whiteacre must be equally bound for the same debt.[24] Where Blackacre is primarily liable to pay A.'s claim, and Whiteacre is only secondarily liable to that claim, B. cannot force the burden of A.'s debt onto Whiteacre.[25]

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[18] See also *McCarthy* v. *McCartie (No. 2)* [1904] 1 I.R. 100, 115.
[19] See also *The "Chioggia"* [1898] P. 1.
[20] *Op. cit.*, § 69.
[21] (1811) 17 Ves. 314; 514.
[22] The decision in the case of *Lathrop and Dale's Appeal*, 1 Pa. 512 (1845) (discussed in Dixon, *op. cit.*, 94-5, Sheldon, *op. cit.*, § 71, and Harris, *op. cit.*, § 96), seems inconsistent with that in *Ex parte Kendall.*
[23] *Ex parte Kendall* (1811) 17 Ves. 314; 514, 520-1; *Going* v. *Farrell* (1814) Beatty 472; *New Zealand Mercantile and Loan* v. *Loach* (1912) 31 N.Z.L.R. 292; *In re Manawatu Transport Ltd.* (1984) 2 N.Z.C.L.C. 99,084; Meagher, Gummow and Lehane, *op. cit.*, § 1109; Sheldon, *op. cit.*, § 69: "And the general rule that courts of equity will marshal securities only among creditors of the same debtor is subject to the exception that equity will enforce a duty on the part of one debtor to pay in exoneration of another, by subjecting first the property of the principal debtor"; Cleaver, "Marshalling," (1991) 21 V.U.W.L.R. 275, 285. In *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corporation* (1920) 57 D.L.R. 500 (at 505 *per* Riddell J.; 506-7 *per* Masten J.), debtor 1 had mortgaged Blackacre to A, and debtor 2 had mortgaged Whiteacre to A for the same debt, each receiving different amounts of the consideration. Debtor 1 then mortgaged Blackacre to B., and sold it to debtor 2, who became liable to indemnify debtor 1. It was held that, in these circumstances, B. could marshal, and, when A. recovered against Blackacre, B. could be subrogated to A.'s rights against Whiteacre.
[24] Sheldon, *op. cit.*, § 68.

(iii) B. must have a Proprietary Interest in Blackacre

Marshalling is only available to protect a creditor who has a security or proprietary interest in a fund deriving from the debtor.[26] This is illustrated by the case of *Anstey* v. *Newman*.[27] In that case, the settlor executed a voluntary settlement of Whiteacre, and later granted a mortgage to A. of Whiteacre and his unsettled estates, here Blackacre. On his death, his unsecured creditors claimed to have his assets marshalled, by throwing the mortgage entirely on Whiteacre, and leaving Blackacre for the payment of their claims. Lord Romilly M.R. stated that the voluntary settlement would be void as against subsequent purchasers for value, but only to the extent necessary to give effect to the subsequent conveyance for value. The result was that A. should first resort to Blackacre, and only recover from Whiteacre if the former proved insufficient: "no question of marshalling in favour of unsecured creditors could arise."[28]

(iv) A. must have a Proprietary Interest in Blackacre and Whiteacre

There is some authority to the effect that the doctrine of marshalling can only apply where A. has a proprietary interest in each of the two funds; if he has a proprietary interest in Blackacre, but only a personal interest, or a right of set-off, in another fund, notionally "Whiteacre," he cannot be compelled by B. to resort to the latter.[29]

(v) A.'s two funds must be "in Court"

This is a supposed further requirement in order for a court to order that B. should be subrogated to the position of A. or that estates be administered so as to preserve the security of B. This was stated to be a requirement by Brett M.R. in *Webb* v. *Smith*.[30] Meagher, Gummow and Lehane dispute the necessity for the funds to be under the control of the court in a case where B. claims to have been subrogated to A.'s

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[25] *In re International Life Assurance Society* (1876) 2 Ch. D. 476. See also *The "Priscilla"* (1859) Lush. 1; *The "Edward Oliver"* (1867) L.R. 1 A. & E. 379; Meagher, Gummow and Lehane, *op. cit.*, § 1112.

[26] This includes purchasers from the "debtor."

[27] (1870) 39 L.J. Ch. 769.

[28] (1870) 39 L.J. Ch. 769, 770.

[29] *Webb* v. *Smith* (1885) 30 Ch. D. 192; Meagher, Gummow and Lehane, *op. cit.*, §§ 1114-1119.

[30] (1885) 30 Ch. D. 192, 199: "[The doctrine of marshalling] applies when the funds are in Court, and when the Court can exercise a jurisdiction over them." See Meagher, Gummow and Lehane, *op. cit.*, § 1117, citing also *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.* [1970] Tas. S.R. 120 and *Lewis* v. *United States*, 92 U.S. 618, 623 (1875); *In re Manawatu Transport Ltd.* (1984) 2 N.Z.C.L.C. 99,084, 99,087, cited by Cleaver, "Marshalling," (1991) 21 V.U.W.L.R. 275, 278. In *McCarthy* v. *McCartie (No. 2)* [1904] 1 I.R. 100, the lands had already been sold in the course of an administration suit. Walker L.J. stated (at 119-120) that the case was one "to be dealt with as if the Court had all the funds before it," and was "eminently a case in which [a right of marshalling, if it existed] should be applied."

rights against Whiteacre.[31] They refer to the decision in *Lawrence* v. *Galsworthy*,[32] where Stuart V.-C. made a decree relating to a policy which had not yet been paid, which clearly was not "in court." However, all the persons who might have claimed the policy proceeds were parties to the suit, so they were all bound by the decree.

12.3 Limitations on the Availability of Marshalling: The Rights of a Third Party in Whiteacre

The discussion above relates to the situation where the mortgagor mortgages Blackacre and Whiteacre to A., and then Blackacre alone to B. In that case, B. will be subrogated to A.'s rights against Whiteacre if A. exhausts Blackacre. However, the mortgagor may afterwards have mortgaged, or otherwise disposed of Whiteacre to C. In this situation, there exists a considerable conflict of authority as to the proper result. In a series of predominantly English cases dealing with the situation where B. is a mortgagee of Blackacre, and C. is a subsequent mortgagee of Whiteacre (or of Blackacre and Whiteacre), the courts denied B. the right to marshal the prior charge (that of A.) onto Whiteacre. The reason for this was that this would have the effect of prejudicing the rights of C., a third party, and that marshalling could not be allowed where it would have the effect of interfering with the rights of a third party. Rather than allowing B. to force A.'s mortgage onto Whiteacre, the result adopted in these cases was to apportion A.'s paramount charge rateably between Blackacre and Whiteacre.[33] If C. has interests in both Blackacre and Whiteacre, the result will be the same.[34]

12.3.a Particular case of Successive Purchasers of Land subject to common Incumbrance

For the purposes of examining one particular situation where the views of the courts have been divided, we take a factual situation where Blackacre and Whiteacre are two plots of land in the hands of the debtor, each subject to A.'s lien. B. buys Blackacre from the vendor for valuable consideration. The vendor is held under a duty to exonerate him from A.'s lien. C. then buys Whiteacre. If A. wishes to

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[31] *Op. cit.*, § 1117. However, A. is a necessary party to the suit: *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corporation* (1920) 57 D.L.R. 500, 506 *per* Riddell J.

[32] (1857) 3 Jur. (n.s.) 1049.

[33] See, *e.g.*, *McCarthy* v. *McCartie (No. 2)* [1904] 1 I.R. 100, 105 *per* Porter M.R.; [1904] 1 I.R. 100, 115 *per* Walker L.J.; *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corporation* (1920) 57 D.L.R. 500, 507 *per* Masten J.; *Victoria & Grey Trust Co.* v. *Brewer* (1970) 14 D.L.R. (3d) 28; *National Bank of New Zealand Ltd.* v. *Caldesia Promotions Ltd.* [1996] 3 N.Z.L.R. 467. In *Victor Investment Corp. Ltd.* v. *Fidelity Trust Co.* (1971) 23 D.L.R. (3d) 722, B. had paid off A., and obtained an assignment of his mortgage over Blackacre and Whiteacre. B. also acquired the equity of redemption in Blackacre. When B. paid off A., the purchase price was apportioned between the two properties with a disproportionate part of the price attributed to Whiteacre. The effect was that A.'s mortgage, in the hands of B., apparently stood charged on Blackacre for an amount in excess of the actual value of Blackacre. B. commenced foreclosure proceedings against Blackacre. C. now brought this action in respect of "misapportionment" of the first mortgage, seeking to restrain the foreclosure. The court granted such an order, holding that the first mortgage (that of A.) should have been apportioned rateably between Blackacre and Whiteacre.

[34] *Contra*: *Conrad* v. *Harrison*, 30 Va. (3 Leigh) 532 (1832).

enforce his lien against Blackacre, can B. force the burden onto Whiteacre, or should A.'s charge be apportioned between Blackacre and Whiteacre?

Most English courts seem to have favoured the latter result as the fairer: B. and C. share the burden between them, their order of purchase being an arbitrary factor.[35] However, Irish and American decisions almost uniformly hold that when B. buys Blackacre, the debtor/vendor became bound to exonerate him, and so did Whiteacre, the remaining property subject to the charge in his hands. Further, this onus to exonerate Blackacre is not lifted when C. acquires Whiteacre. As the land was burdened in the debtor's hands, so is it in C.'s hands.[36] If there are more than two purchasers of two plots, the same rule applies, the result being known as the "inverse order of alienation rule." Story[37] acknowledged that this line of authority represented the settled doctrine of the United States. He added that he thought it to be

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[35] *Barnes* v. *Racster* (1842) 1 Younge & Coll. C.C. 401.

[36] Irish cases: *Hartly* v. *O'Flaherty* (1833) Ll. & G. *temp.* Plunket 208; *Aicken* v. *Macklin* (1838) 1 Dr. & Wal. 621, 633. American decisions include: *Gill* v. *Lyon*, 1 Johns. Ch. 447 (N.Y. 1815); *Clowes* v. *Dickenson*, 5 Johns. Ch. 235, 240 (N.Y. 1821); *Nailer* v. *Stanley*, 10 Sergeant & Rawle 450; 13 Am. Rep. 691 (Pa. 1823); *Governeur* v. *Lynch*, 2 Paige Ch. 300 (N.Y. 1830); *Conrad* v. *Harrison*, 30 Va. (3 Leigh) 532, 545 (1832) *per* Tucker P.; *Jenkins* v. *Freyer*, 4 Paige Ch. 47 (N.Y. 1833); *Stoney* v. *Schultz*, 1 Hill Ch. 465; 27 Am. Dec. 429 (S.C. 1834); *Guion* v. *Knapp*, 6 Paige Ch. 35 (N.Y. 1836); *Schryver* v. *Teller*, 9 Paige Ch. 173 (N.Y. 1841); *Jones* v. *Myrick's Executors*, 49 Va. (8 Gratt.) 179, 212 (1851); *Brown* v. *Simons*, 44 N.H. 475, 478-9 (1863); *Alley* v. *Rogers*, 60 Va. (19 Gratt.) 366, 389 (1869); *Barnes* v. *Mott*, 64 N.Y. 397, 402; 21 Am. Rep. 625, 628 (1876); *Savings Bank* v. *Cresswell*, 100 U.S. 630, 643; 25 L. Ed. 713 (1879); *Miller* v. *Holland*, 84 Va. 652, 654-5; 5 S.E. 701 (1888) (quoting from *Hartly* v. *O'Flaherty* (1833) Ll. & G. *temp.* Plunket 208, 216, and applying the rule where A. was a volunteer, and B. a purchaser for value); *Jackson* v. *Finance Corporation of Washington*, 41 F. 2d 103, 106-7; 59 App. D.C. 309 (1930); *Fidelity & Casualty Company of New York* v. *Massachusetts Mutual Life Insurance Co.*, 74 F. 2d 881, 884; 35-1 U.S. Tax Cas. (C.C.H.) P9298; 14 A.F.T.R. (P-H) 940 (4th Cir. 1935); *Commonwealth Land Title Co.* v. *Kornbluth*, 175 Cal. App. 3d 518, 527; 220 Cal. Rptr. 774 (1985); *In re Cook*, 67 B.R. 240, 242, note 2 (Bkrtcy. D. Minn. 1986); Harris, *op. cit.*, §§ 75-76.

[37] *Op. cit.*, § 1233 (a).

of doubtful validity in principle as it was hard to see how any one of several successive purchasers or incumbrancers could have a greater equity than the others.

CHAPTER 13

CONCLUSION

13.1 Historical Review

Subrogation is a word which describes the legal substitution of one party for another, with a view to the exercise of the rights of that party against a third. The historical theory which was advanced here was that at least three separate legal institutions were subsumed into the concept "subrogation."[1] The first of these was the right of a paying surety or co-debtor to an assignment of any securities held by the creditor from the principal debtor or another surety or co-debtor, in order to obtain indemnification or contribution. The second institution was the right of a party with an interest in property, typically an incumbrancer, to pay off an incumbrance on the property and to succeed to the rights of the owner of that incumbrance, without any necessity for an express assignment. The third principal institution was the right of an indemnity insurer, upon paying the insured, to succeed to the rights of the insured against any third party which was liable for the insured loss. These institutions appear to have been recognised in equity or in common law courts long before anyone thought to connect them.[2] It seems that first French, and then American authors drew some or all of these separate elements together under the heading of subrogation.[3] They were, it seems most likely, connected because each involved the transfer of rights from one person to another, though expressed in the metaphor of the substitution of one person for another. In civil law systems, it seems that subrogation by operation of law (legal subrogation) and contractual or conventional subrogation have usually been clearly distinguished. In common law systems, views have differed as to the legal nature of subrogation in a number of contexts in the absence of an express contractual provision. These views are considered below.

13.2 Common and Divergent Characteristics of Instances of Subrogation

Although the metaphor of substitution may have suggested some deeper connections, the specimens of subrogation nonetheless retained distinctive characteristics.

13.2.a The Nature of the Right

The first level where differences were (and remain) apparent related to the nature of the right which is described as "subrogation": whether a party who was entitled to subrogation was substituted *ipso facto* to the position of the creditor, or whether he was merely clothed with a right to require the creditor

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[1] Section 1.5, *ante*.
[2] See section 1.5, *ante*.

to assign his rights to him. It seems that under the Roman law, a surety, *provided that he sought an assignment*, was entitled to all the rights of the creditor. By contrast, where one creditor took the place of another, the transfer was automatic, but he might not succeed to all the other's rights.[4] As regards the surety's position in the common law, perhaps the best view on principle was that of Dixon,[5] who likened a right to subrogation as a mere equity *inter partes* to demand the assignment of the creditor's rights. Until the assignment took place, the right would only bind third parties who had notice of it.[6] The right would only become absolute upon the assignment. Therefore, the right of subrogation was analogous to an equitable assignment of a right of action (although Dixon did not use quite that language).

It must be granted, however, that later cases have moved some distance away from this view. In Ireland and England, section 5 of the Mercantile Law Amendment Act 1856, which codified the surety's right of subrogation, seemed to envisage "automatic subrogation," although the authorities were divided on the nature of the right, largely because of the prolix wording of the section, which referred both to a right to require an assignment, *and* to a right to stand in the place of the creditor.[7] The insurer also appears to need the consent of the insured before he can proceed against the third party.[8] In Ireland and England, this is no doubt a consequence of the rule that the insurer can only pursue the third party in the name of the insured. Therefore, the insurer's right appears to be one to require the insured to lend his name to an action brought by the insurer against a third party liable for the loss. Even so, it does not appear that the insurer requires an actual assignment of the insured's right of action.

In other contexts in modern common law jurisdictions, the payer seems to be regarded as "automatically" subrogated to the creditor's rights. This seems to be so in at least some cases of the subrogation of incumbrancers who pay off a charge on land in which they are interested. This parallels the Roman law. However, it may be correct to say that in principle, in most cases, the payer's right is one to require an assignment or transfer of rights. There have even been suggestions that the right is akin to a beneficial interest in a right of action, which is subject to a form of constructive trust in the hands of the creditor.[9] However, the *dicta* favouring this theory are sparse enough, and there may be some difficulties in imposing the duties of a trustee on the insured or creditor. It may be correct to say that the surety or insurer acquires a proprietary right *in* the cause of action. It does seem that in many cases, a court will enforce a right of subrogation as if an assignment had taken place, equity treating as done that which

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[3] See section 1.5, *ante*.
[4] See sections 3.9 and 3.10.
[5] *Substituted Liabilities; A Treatise on the Law of Subrogation* (1861), 50 *et seq.* This seems to reflect Dixon's Roman-influenced view: the right is like the Roman law benefit of the cession of actions.
[6] Dixon, *op. cit.*, 6. *Cf. Bowker* v. *Bull* (1850) 1 Sim. (n.s.) 29; section 7.8, *ante*. However, Dixon also noted that the Roman law recognised the "automatic" subrogation of subsequent incumbrancers who paid off prior incumbrancers.
[7] See sections 3.9, 7.6.a and 7.8, *ante*.
[8] See section 3.9, *ante*.
[9] P. Birks, *An Introduction to the Law of Restitution* (1985, rev. ed. 1989), 94. See section 3.9, *ante*.

ought to be done. Mitchell seems to favour the view that subrogation should be automatic.[10] This is perhaps linked to his theory that subrogation is a remedy rather than a substantive right.[11]

13.2.b The Extent of the Right

It has been seen that it is now widely accepted that subrogation can take place to some only of the creditor's former rights.[12] This "limited subrogation" seems only to arise in cases where a lender or payer is unable to enforce some or all of the terms of the contract by which he was to be repaid, and therefore claims to have been subrogated to the rights of a prior creditor. The payer will generally not be allowed to improve his position by means of subrogation beyond obtaining rights similar to those for which he had initially bargained.[13] The possibility of a limitation on the extent of subrogation, with a possibly increased scope for judicial discretion, may be regarded as tending to increase the degree of diversity within as well as between instances of subrogation.

Perhaps the only proposition which seems true of every instance of subrogation is that the payer cannot recover by subrogation more than he himself paid, with an allowance for interest and costs.[14] The explanations proffered for this appear to turn on an argument that the payer is to be regarded as in some manner a fiduciary for the debtor, and that he cannot be permitted to make a profit by his payment. In the civil law, this seems to have been regarded as something like a conclusive presumption against the payer, and thus, theoretically as being based on his intention.

13.2.c The Circumstances Attending the Exercise of the Right

The next level where differences exist relates to the circumstances in which the right can be exercised. Civil law systems seem to recognise a general rule that a payer of a debt cannot be held to have been subrogated unless he has paid the entire of that debt.[15] Mitchell feels that a similar rule operates in common law jurisdictions.[16] However, as has been seen, the common law as applied in Ireland and England adopts different approaches depending on the nature of the payer. The courts in those countries seem to apply a similar rule in cases of suretyship and insurance (in each case subject to rather elaborate qualifications),[17] but not in cases of payers of incumbrances with an interest in land[18] or of lenders.[19] It

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[10] C. Mitchell, *The Law of Subrogation* (1994), 60. Admittedly, this is in the context of the interpretation of section 5 of the Mercantile Law Amendment Act 1856, rather than a general proposition.
[11] He does not himself seem to make any such connection.
[12] See section 3.10, *ante*.
[13] *Loc cit.*
[14] See section 3.4, *ante*.
[15] See section 2.3, *ante*.
[16] *Op. cit.*, 41.
[17] See sections 2.3.c and 2.3.d.
[18] See sections 2.3.e and 2.3.f.

seems that the civil law view is based on the intention of the creditor who is paid. If intention is not accepted as being the basis of many cases of subrogation in the common law, then there may seem to be less justification for the rule.[20]

13.3 Attempted Syntheses of Subrogation

The differences outlined, and the other inconsistencies between categories do suggest that no complete fusion of the disparate institutions which seemed to coalesce has been effected. The inconsistencies and occasional confusion created have led some to attempt a rationalising synthesis of the elements of subrogation. These attempts tend to find their focus in the *reason* why subrogation takes place.

13.3.a Intention and Subrogation

In his nineteenth century work on subrogation,[21] influenced by civil law writers, Dixon acknowledged the existence of legal subrogation, that is, subrogation by operation of law rather than by express agreement of the parties. However, he regarded it as being in some cases no more than a right to demand a legal assignment of a right of action. In those cases, it seems that the payer had to demand the actual assignment from the debtor. He described such a case as subrogation derived from "the law and a stipulation combined."[22] Thus, an act of intention was required in order to give effect to an underlying right which the law recognised. Roman law (and Dixon) also recognised conventional or contractual subrogation, which derived purely from the demand of the payer. One example was the subrogation of a creditor who lent funds to the debtor in order to pay off another creditor.[23] However, where a subsequent incumbrancer paid off the charge of a prior incumbrancer, the subrogation was automatic. There seems to have been little enough debate on the reason why subrogation took place in such a case. However, Dixon offered the view that, as the law gave him the right to pay off the prior charge in order to assure his own security, it would be unjust that this should turn to his disadvantage by advancing in priority creditors who were subsequent to him.[24] It could be argued that this is an early foreshadowing of the concept of unjust enrichment.[25]

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[19] See section 2.3.f.
[20] The role of intention is further discussed at section 13.3.a, *post.*
[21] *Substituted Liabilities; A Treatise on the Law of Subrogation* (1861).
[22] *Op. cit.*, 9. As regarded the surety, he stated that subrogation did not occur automatically, but only because some act on the part of the surety was necessary to show his wish to obtain the creditor's rights: *op. cit.*, 45, 51, 63.
[23] Dixon, *op. cit.*, 10, 12.
[24] *Op. cit.*, 14-15.
[25] *Cf.* Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 245, who concludes from *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737

However, it seems that under the Roman law, if a third party payer or lender paid or lent funds to pay off another creditor, his only right to subrogation could be contractual. In other words, he would only be entitled to subrogation if he demanded it from either the debtor or creditor. It seems that the French writers on subrogation, though acknowledging that subrogation was sometimes a creature of contract, and sometimes occurred by operation of law, never attempted to make any connection between subrogation and unjust enrichment or any of its civil law analogues.[26] In the nineteenth century, English and American judges made a number of statements to the effect that subrogation operated to serve the ends of natural justice.[27] However, it seems that it was only in the twentieth century that American and English writers attempted to explain subrogation as operating to reverse or prevent an unjust enrichment.

Many nineteenth century Irish and English spoke of the *presumed intention of the payer* as a ground for subrogation in cases of payments by a third party with an interest in land or a lender.[28] It was acknowledged that the *surety's* rights to subrogation, indemnification and contribution arose as doctrines of equity rather than as matters of contract.[29] Even so, it was acknowledged that the notoriety of such an equitable right might have caused the parties to enter into the contract on the understanding that the equitable right would attach.[30]

There can be no doubt that express contractual subrogation is possible.[31] Where there is no express agreement, the intention or presumed intention of the parties may be of importance. It seems that if the payer intended to be subrogated by his payment, there is no requirement for a common intention on the part of the debtor.[32] Although, as has been seen, Birks explained some cases of subrogation as being a restitutionary claim, he acknowledged the possibility that it occurred in other cases as a result of the

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that the enrichment of subsequent creditors of the debtor is material in deciding whether subrogation should be granted as a restitutionary remedy.

[26] *Cf.* J. Mestre, *La Subrogation Personnelle* (1979), n°s 17-21.

[27] See section 1.3, *ante*.

[28] See section 4.1, *ante*.

[29] *Stirling* v. *Forrester* (1821) 3 Bli. 575; *Gardner* v. *Brooke* [1897] 2 I.R. 6, 12 *per* O'Brien J.: see section 7.3, *ante*.

[30] *Craythorne* v. *Swinburne* (1807) 14 Ves. 160, 171 *per* Lord Eldon L.C.; *Chipman* v. *Morrill*, 20 Cal. 130, 135 (1862) *per* Field C.J.: see section 7.4, *ante*.

[31] See Mitchell, *op. cit.*, chapter 13. For an example, see *In re M.F.N. Construction Ltd.*, unreported, Supreme Court, McCarthy J., *nem. diss.*, 12th May 1988, at 4. Note also *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95, 119 and *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744 *per* Lord Hoffmann.

[32] *Cf. Chetwynd* v. *Allen* [1899] 1 Ch. 353; *Butler* v. *Rice* [1910] 2 Ch. 277; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 745 *per* Lord Hoffmann. Lord Hoffmann does seem to have thought that common intention was necessary for "contractual subrogation"; if there was no common intention, subrogation would have to be explained as a remedy to reverse unjust enrichment. However, if *consensus ad idem* is a necessary element of a binding contract in the common law, it may be preferable to explain subrogation as occurring at times because of the intention of the payer, even if the formalities of a contract may not exist. See also section 4.1, *ante*.

intention of the *payer*.[33] Recent House of Lords decisions seem to have regarded the subrogation of insurers as contractual in nature, operating as a consequence of the principle of indemnity.[34]

13.3.b The Unjust Enrichment Thesis

In England, Birks theorised that, at least in some cases, subrogation was a restitutionary claim to "value surviving" in the "hands" of a recipient in the form of a discharged debt.[35] In other words, a discharged claim was the traceable product of money with which the claimant had parted. The claim was realised or effected through the metaphor of subrogation. The claim could only be allowed if the claimant could show that he had parted with the money under circumstances which made it unjust for the person whose debt had been discharged to escape from the obligation of paying that debt.

Mitchell has accepted this. However, correctly observing that Birks' scheme did not explain some cases where subrogation occurred although the debt was not discharged, he developed a separate hypothesis, also based on unjust enrichment, to explain such cases.[36] Birks' theory could not explain such cases in restitutionary terms, although he might explain them as examples of contractual or intentional subrogation. Mitchell, however, theorised that in such cases, subrogation occurs in order to prevent the enrichment *either* of the third party, who might otherwise escape liability, or of the recipient of the payment, who might obtain a double recovery.

One difficulty with this reasoning is that, strictly speaking, in such a case, subrogation does not operate in a restitutionary fashion: on Mitchell's hypothesis, it operates to *prevent* an unjust enrichment rather than to *reverse* one. Mitchell later acknowledged this. He therefore seemed to accept that subrogation in such a case was not restitutionary, although he felt that it was still a response to an anticipated unjust enrichment.[37] Other difficulties arise out of the attempt to identify "unjust factors" which justify the granting of a restitutionary remedy. Mitchell identifies many cases as instances of legal compulsion. These include the cases of insurers and sureties. However, ordinarily an insurer or surety enters into his obligation voluntarily, and possibly for reward, in the knowledge that he may be called upon to pay.[38] No doubt it is correct that he should be permitted to shift the ultimate burden of the debt

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[33] *Op. cit.*, 391-2.
[34] *Napier* v. *Hunter* [1993] A.C. 713; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744 *per* Lord Hoffmann.
[35] *Op. cit.*, 93-98, 372-5; section 1.3, *ante*.
[36] See section 1.3, *ante*.
[37] See section 1.3, *ante*, and Mitchell, *op. cit.*, 10. See also *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744-5 *per* Lord Hoffmann, referring to subrogation in some cases as an equitable remedy "to reverse or prevent unjust enrichment."
[38] In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744, Lord Hoffmann effectively said that the subrogation of insurers was contractual in nature: "the doctrine of subrogation in

onto another, but this outcome can be justified on grounds of public policy rather than on the ground of a legal compulsion imposed on him.[39] It is also worthwhile to quote an American critic of Mitchell's hypothesis, writing in the insurance context:

> "subrogation is based on a social policy to avoid unjust enrichment. But it is also based on policies that liability should follow fault, or at least product defect, and that injured persons should not be overcompensated. These two social policies, when worded this way, are not so clearly restitutionary in nature... They are just as likely to be principles of (or, policies underlying) purely legal remedies."[40]

Another difficulty which arises, in relation to each of Mitchell's forms of subrogation, is the nature of the "enrichment" which subrogation is supposed to prevent or reverse. First, as has been seen, there is a universally observed rule that a payer can recover no more through subrogation than the amount which he himself paid.[41] It would appear that the amount of a defendant's enrichment is the amount of his liability which is discharged, or which he will not be called upon to pay. If, however, the payer settles the debt at a discount, his recovery is limited to the amount which he paid, with interest and possibly costs. The enrichment to the defendant was greater than the amount paid by the plaintiff in settlement of the debt.[42] Further, however, the defendant cannot be said to have been enriched by the amount of costs paid by or incurred by the plaintiff.[43]

Another issue which arises is whether or not a tracing exercise is necessary before subrogation can take place. A somewhat recondite controversy has arisen as to whether "restitution" can be an appropriate description of a right or claim consequent upon a tracing exercise. On one view, a tracing process is always necessary before any restitutionary claim can be made. Further confusion surrounds the question whether a tracing process is necessary before one can be held to have been subrogated to the rights of another.[44] Mitchell seems to think that this is the case.[45] Birks seems to identify subrogation as a form of "claim" (using Smith's terminology) to an asset in the form of a discharged debt.[46] He thinks that a tracing process is a necessary prerequisite in order to identify the asset. Smith does not regard a discharged debt as the traceable product of a payment: rather, he would state that the payment is traceable

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insurance rests upon the common intention of parties and gives effect to the principle of indemnity embodied in the contract."

[39] See also section 1.4, *ante*.

[40] Quinn, "Subrogation, Restitution, and Indemnity," (1996) 74 Tex. L. Rev. 1361, 1398.

[41] Section 3.4, *ante*.

[42] Mitchell acknowledges this point: *The Law of Subrogation* (1994), 55, note 19.

[43] See sections 7.1 and 7.2, *ante*.

[44] Birks, *op. cit.*, 96-8, 363-5; L.D. Smith, *The Law of Tracing* (1997), 152-4.

[45] *Op. cit.*, 39. Smith does not appear to think it necessary in cases of "simple subrogation": *op. cit.*, 152 note 82.

[46] *Op. cit.*, 93.

into an asset purchased earlier, by means of which the debt was incurred.[47] Birks would further argue that, as a "claim" to subrogation is one to an asset other than that with which the payer parted, it is necessarily restitutionary in nature. Others would say that the claim is one to a substitute for the original property, and is proprietary in nature.[48] The view advanced here was that presumptions of the manner in which a recipient applied moneys may take the place of tracing in many subrogation cases.[49] It is notable that few "claimants" have failed to date in claims that they have been subrogated on the ground that they could not identify the manner of application of the money which they initially paid.[50]

13.4 Evaluation of Aspects of Subrogation in the Light of these Theories

The view favoured here was that, in theory, a right of subrogation is a right to demand that a creditor make his rights against a third party available to a payer. In some contexts, however, it seems to be practically automatic or self-executing. Section 5 of the Mercantile Law Amendment Act 1856 is arguably a provision which "executes" the right. If a payer goes to court seeking to enforce this right, he would normally seek a declaration that he has been subrogated, and perhaps other relief. In other words, he seeks a judicial statement of his rights in the events which have occurred. Subrogation is a name given to the right which is realised or enforced by a declaration or other relief.[51]

On the other hand, some regard subrogation as a remedy, and specifically one to reverse or prevent an unjust enrichment.[52] This seems to imply that the right which a payer has is one to restitution or to anticipatory relief against unjust enrichment, and that "subrogation" is a judicial remedy to give effect to that right. Hence, Birks' argument that the word "subrogation" was meaningless in itself, and merely denoted a restitutionary remedy given in certain cases.[53]

Mitchell seems to take the view that the surety's right under section 5 of the Mercantile Law Amendment Act is "automatic."[54] Since Mitchell is critical of the breadth of section 5 in other regards, he is perhaps seeking here to explain the existing law rather than attempting to prescribe the form which he

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[47] *Op. cit.*, 153.
[48] Section 6.4, *ante* and authors there cited.
[49] Section 2.2, *ante*. See also Villiers, *op. cit.*, 244, who notes (at note 131) that Lord Hoffmann, as counsel in *Paul* v. *Speirway Ltd. (in liq.)* [1976] Ch. 220, 229, seems to have argued that tracing was not a necessity before one could be held to have been subrogated.
[50] The exception is *Parkash* v. *Irani Finance Ltd.* [1970] Ch. 101.
[51] Dixon, *op. cit.*, characterised the right of subrogation as a right to require an assignment of the creditor's rights. Nonetheless, he referred to it as an "equitable remedy": *op. cit.*, 47.
[52] Mitchell, *op. cit.*, 4; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744-5 *per* Lord Hoffmann
[53] Birks, *op. cit.*, 93-8, 372-5.
[54] *Op. cit.*, 60. Dixon's view was to the contrary, holding that the surety's right of subrogation depended upon his intention to be subrogated: *op. cit.*, 45, 51. Indeed, he was of the view that this intention had to be expressed, the natural presumption being that he intended to discharge the creditor's rights: *op. cit.*, 51.

feels the law should take. However, he favours a (very) limited discretion to "withhold the remedy" of subrogation at least in some contexts.[55] This view appears to be predicated upon a belief that subrogation does not take place until "granted," or ordered by a court. There may be some difficulties in reconciling these two views.[56]

In relation to the supposed rule that a payer cannot be subrogated unless he has paid the entire of the debt,[57] it seems that the only rationale for applying the rule in the civil law was based on the creditor's intention:[58] he would not have accepted the payment if by so doing he would impair in some manner his prospects for recovering the remainder of his claim. If the only explanation for the rule is one based on real or supposed intention, it seems hard to reconcile it with a restitutionary analysis. Indeed, in *Parc*,[59] the House of Lords, meaning to apply subrogation as a restitutionary remedy, refused to follow this rule. This result may be justifiable, as the enrichment to other parties (*i.e.*, subsequent creditors of the debtor) would be measured by the extent to which they would be advanced in priority if subrogation did not take place. This can be prevented by holding that the payer has been subrogated to the creditor's rights, but that the payer's right to participate in the security is postponed until the original creditor has been paid in full. Since the proper extent of the rule itself remains open to question in Ireland and England,[60] it would perhaps be unwise to draw any conclusions from its supposed operation alone.

There are, as has been seen, numerous judicial statements to the effect that a voluntary payer of a debt should not be held to have been subrogated to the creditor's rights.[61] However, it is also universally accepted that if the payer paid at the request of the debtor, then he should be entitled to reimbursement, and very often he is also held entitled to subrogation. If he paid at the request of the creditor but not of the debtor, then, in the absence of any element of compulsion or necessity, it may be proper to say that his payment is voluntary *vis-à-vis* the debtor and should not entitle him to reimbursement from him.[62] However, in the writer's view, following an argument approved of in certain American cases,[63] as the creditor was willing to accept the payment, it should not be treated as voluntary as far as he is concerned, and he should be liable to assign his rights against the debtor to the payer, if the latter requests it.[64] This is also analogous to the Roman view of payment by a surety as being in some ways akin to a sale of a right

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[55] *Op. cit.*, 44-6.
[56] *Cf.* Barr J. in *In re Chipboard Products Ltd. (in liquidation)*, unreported, 1984 No. 7316 P, 20th October, 1994 at 11, referring to a judicial discretion to grant the "right" of subrogation.
[57] Section 2.3, *ante*.
[58] Section 2.3.a, *ante*.
[59] *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737. See section 2.3.e, *ante*.
[60] See sections 2.3.b *et seq.*, *ante*.
[61] Section 3.8, *ante*.
[62] *Cf.* the cases considered in section 3.8.a, *ante*. See also Meier, "Mistaken Payments in Three-Party Situations: A German view of English Law," (1999) 58 C.L.J. 567, 569-70.
[63] *Mathews* v. *Aikin*, 1 N.Y. 595 (1848); see section 3.8.a, *ante*.
[64] See sections 3.8.a and 4.1, *ante*.

of action by the creditor to the surety.[65] Authors who insist that subrogation is solely restitutionary seem generally hostile to any recognition of subrogation in circumstances where a personal right of indemnification is not allowed.[66] The matter is not settled in Ireland or England.[67]

13.4.a The Extent of Subrogation and the Unjust Enrichment Theory

It has been seen that a court may hold that a payer has been substituted to some only of the creditor's rights.[68] This can perhaps be taken as supportive of the view of subrogation in some cases as a form of restitutionary remedy, because a partial substitution looks rather more like the granting of a remedy than it does an intentional transfer of rights: a judicial determination would appear to be necessary in order to decide the extent of the rights to which the payer should be subrogated. If so, however, it is notable that the extent of the "remedy," or of the rights to which the payer is subrogated, is or are measured by the rights which the payer *intended* to acquire.[69] Thus, in *Parc (Battersea) Ltd.*,[70] the lender had only intended to obtain personal rights against companies associated with the borrower. The majority of the House of Lords therefore held that it had been subrogated to the secured rights of a creditor only as against the party against whom the lender had intended to enjoy priority. A minority seems to have held that there should be subrogation to the personal rights of the former creditor only.[71] The majority of the House of Lords regarded subrogation *in that case* as a restitutionary remedy. However, Lord Hoffmann was at pains to emphasise that one category of subrogation was based on intention, another on unjust enrichment.

Birks has advanced an argument that where subrogation operates as a restitutionary remedy, subrogation to a proprietary right should only be allowed if the payer can show that he retained property in the money which he paid.[72] As this would be a rare occurrence, this theory would exclude subrogation to proprietary rights in a great many cases.[73] There appear to be numerous cases which are inconsistent with Birks' theory. There seem to be three conclusions which could be drawn. First, that those cases are wrong. Secondly, that Birks' theory is wrong. Thirdly, that Birks' theory does not offer a complete description of the cases where subrogation to a proprietary right can occur. Birks does acknowledge that if

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[65] See Dixon, *op. cit.*, 5 and section 7.1, *ante*.
[66] Mitchell, *op. cit.*, 162-7. At 166, he writes that "a volunteer is by reason of his status no more entitled to subrogation than to any other restitutionary remedy." Compare Villiers, "A path through the subrogation jungle: whose right is it anyway?" [1999] L.M.C.L.Q. 223, 226, arguing that the supposed prohibition on the subrogation of volunteers was no more than an early adumbration of a requirement that one claiming to have been subrogated must prove an unjust factor which entitles him to subrogation.
[67] *Cf.* section 4.1, *ante*.
[68] Section 3.10, *ante*.
[69] *Cf.* Villiers, *op. cit.*, 228.
[70] *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737.
[71] See section 6.2.d, *ante*.
[72] *Op. cit.*, 390.
[73] See section 3.10, *ante*.

subrogation occurs as a consequence of the intention or deemed intention of the parties, there should be no need to show a proprietary base.[74] Birks himself therefore, seems implicitly to suggest the third possible conclusion. However, Mitchell adopts the first conclusion.[75] Although Mitchell acknowledges that there is such a thing as contractual subrogation, he seems to regard it solely as concerning express contracts for subrogation.[76] He does not seem to accept that subrogation could occur as a result of an implied term, instead denouncing the language of implied intention as a crude substitute for a restitutionary analysis.[77] Treating subrogation as almost invariably a restitutionary remedy, he therefore finds little scope for subrogation to proprietary rights. He is therefore driven to assert that large numbers of cases were wrongly decided, and that at least one long-standing statutory provision produces an "unjustifiable" result.[78]

Mitchell's hostility to "presumed intention" is directed particularly against a long standing presumption applied by the courts, to the effect that where one pays an incumbrance on the property of another, one is presumed to have intended to obtain the rights of the incumbrancer, in the absence of indications to the contrary.[79] This presumption is based on the intentions of the parties, and Mitchell regards it as incompatible with his theory of subrogation as a restitutionary remedy. However, the present writer feels that weight should be attached to the reasoning expressed by the courts in those cases: that, in the absence of evidence of any other intention, the courts would presume that the payer had intended as best as possible to secure his repayment, by obtaining the rights held by the former creditor. If one can first accept that subrogation is in some cases based on the intention of the payer, then it does not seem a very great extension of this thesis to accept that that intention need not always be express. If so, it seems reasonable to infer that in certain cases, where the payer has been silent as to his intentions, he nonetheless intended (or would have chosen, had he directed his mind to the question) to protect his position as best he could, by obtaining the rights held by the former incumbrancer.[80] It may, on the other hand, be argued that the existence of such a presumption shifts the burden of proof onto the debtor or subsequent creditor who denies that subrogation has taken place, without adequate justification.[81] It

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[74] *Op. cit.*, 391-2, and section 3.10, *ante*.
[75] Mitchell, *op. cit.*, chapter 3 and 59.
[76] Mitchell, *op. cit.*, chapter 13.
[77] *Op. cit.*, 14-5. Lord Hoffmann expressed similar views in *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 745, 747.
[78] Mercantile Law Amendment Act 1856, section 5; C. Mitchell, *The Law of Subrogation* (1994), 59.
[79] *Loc. cit.*
[80] See, *e.g.*, *Walcott* v. *Condon* (1853) 3 Ir. Ch. R. 1 and section 4.1, *ante*. Dixon also regarded the presumption as proper in the case of a payment by an incumbrancer: *op. cit.*, 17.
[81] *Cf.* Villiers, *op. cit.*, 229, and *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 747 *per* Lord Hoffmann, declining to offer a view on where the burden of proof should lie in showing that the payer intended to be subrogated. He did, however, state that if the intentions of the parties as to whether or not someone had intended to be secured were regarded as factors material to a finding of an unjust enrichment, "it could be argued that on general principles," it was for the payer to make out all the elements of an unjust enrichment. Lord Hutton, on the other hand, stated (at 753) that if a security given by a borrower proved to be defective, subrogation should occur unless its application

should be noted that the courts have long explained a resulting trust as arising because of the presumed intention of a donor. Parallel to Mitchell's attack on presumed intention in subrogation, a similar attack has been made on presumed intention in cases of resulting trusts, in favour of explanations based on unjust enrichment.[82] Without offering any view on the resulting trust cases, it is felt by the present writer that it would be wrong to attempt to force all of subrogation into an unjust enrichment mould.[83] There are nonetheless cases where it is clear that the payer had no intention to be subrogated. Subrogation in such a case is clearly used by the courts in a fashion which is close to that of a remedy. Difficulties may nonetheless exist in describing it as operating as a remedy against unjust enrichment. It has been seen that it does not seem to operate in a fashion measured by the extent of the enrichment of the debtor.

If subrogation is indeed in some cases a remedy, the question arises as to the extent of the judicial discretion, if any, which may exist to withhold it. Lord Denning seemed to believe that such a discretion existed in a case of subrogation of an insurer,[84] but his view has not found general favour or application.[85] There are certainly other *dicta* which seem to indicate that subrogation could be "refused" if there were some factor in the payer's conduct which rendered his claim unmeritorious.[86] However, these statements seem mainly to arise in cases where the payer had made his payment with a fraudulent intent. There has also been a suggestion that a claim for contribution can be resisted on "equitable principles."[87] However, such cases may really involve no more than a question of calculating the proper proportions which each of a number of co-debtors or co-sureties should contribute to the common burden. Outside of these categories, judicial discretion seems to have played a very limited role. If subrogation is applied as a creature of intention, there would appear to be no scope for a judicial discretion to refuse to recognise it, other than in cases where public policy dictated such a result. If subrogation is regarded as a restitutionary remedy, it would appear that certain defences such as change of position or *bona fide* purchase might

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would produce an unjust result. Dixon, *op. cit.*, 45-6, 51, 63-4, argued that the natural effect of payment by a surety, without a request for assignment or subrogation, was to extinguish the creditor's rights. At 64, he states: "Under a system of law which substitutes the surety on payment as of right, the presumption in regard to the extinction of the debt is reversed, so that it becomes necessary to show by positive proof, when such is the fact, that it was the intention of the surety, on payment to relinquish the right of subrogation... The construction given to the transaction by the Roman law was more consistent and natural." On the other hand, the presumption was acceptable where an incumbrancer discharged another incumbrance upon the land: *op. cit.*, 16-17.

[82] R. Chambers, *Resulting Trusts* (1997). The parallel is drawn by Villiers, *op. cit.*, 231.

[83] Rickett and Grantham, "Resulting Trusts - the True Nature of the Failing Trust Cases," (2000) 116 L.Q.R. 15, approve of the use of presumed intent in resulting trust cases, and correspondingly disapprove of an unjust enrichment analysis of those cases.

[84] *Morris* v. *Ford Motor Co. Ltd.* [1973] Q.B. 792, 807.

[85] See section 1.6, *ante*.

[86] See section 3.4, *ante*.

[87] See section 7.3.d, *ante*.

theoretically be available, but it is notable that Mitchell, despite his hypothesis, gives little consideration to these defences.[88]

13.5 Conclusion: The Reasons for Subrogation

Notwithstanding the view of Mitchell, it seems generally to be accepted that the insurer's right of subrogation is an equitable recognition and enforcement of a contractual right.[89] The surety's right has (or had) a basis in statute.[90] This being so, it seems that an attempt to explain its workings as designed to reverse or prevent unjust enrichment is more a guess as to the legislative intent than a prescription of the proper working of the law.[91] There would appear to be at least as good an argument, that in some cases at least, the subrogation of the surety or co-debtor is based on the *intention* of that party.[92] If it is accepted that the surety or co-debtor's right is really one to call for an assignment, this may lend added weight to this argument.

There is also a rather small number of cases where subrogation can be regarded as in some form the product of a property right which a person had, in another form.[93] Certainly, such cases *cannot* be explained on the basis of intention.

In cases of mistaken payment or payment induced by fraud, the only ground for permitting subrogation seems to be vitiated or impaired intention. Therefore, in such cases, subrogation cannot be based on the intention of the payer. He clearly did not intend to be subrogated, but he did not understand the true state of affairs.[94] Typically, he made a payment in the mistaken belief that security which he took would enjoy a certain priority. The effect of subrogation is to place the payer in a position approximate to

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[88] Compare, however, *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 747, *per* Lord Hoffmann, explaining *Orakpo* v. *Manson Investments Ltd.* [1978] A.C. 95 as turning on a policy which precluded the granting of a remedy. However, the reasoning in *Orakpo* seems very clearly to have regarded subrogation, if applicable at all, as an incident of a contract. See section 6.3.a, *ante*.

[89] *Napier* v. *Hunter* [1993] A.C. 713; *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.* [1998] 1 All E.R. 737, 744, *per* Lord Hoffmann (observing that in *Napier*, there was no dispute in the House of Lords that "the doctrine of subrogation in insurance rests upon the common intention of the parties and gives effect to the principle of indemnity embodied in the contract").

[90] Section 5 of the Mercantile Law Amendment Act 1856.

[91] Mitchell, *op. cit.*, 57-60. Mitchell criticises the statute for permitting subrogation generally to proprietary rights. It seems that those sentiments would best be understood as a desire for law reform. In Ireland, of course, the legislature has somewhat trumped any such argument by repealing the Mercantile Law Amendment Act 1856 *in toto*. See section 7.7, *ante*.

[92] As has been seen, judges have sometimes reasoned that parties who are aware of the right to subrogation, may be taken to have entered into a certain contract intending that it should apply: *Craythorne* v. *Swinburne* (1807) 14 Ves. 160, 171 *per* Lord Eldon L.C.; section 7.4, *ante*. Dixon thought that the surety or co-debtor's right of subrogation was always dependent on his intention: *op. cit.*, 51, 64.

[93] See section 6.4, *ante*, and *Newell* v. *Hadley*, 206 Mass. 335, 342; 92 N.E. 507, 510 (1910) and *Wilson* v. *Todd*, 217 Ind. 183; 26 N.E. 2d 1003; 129 A.L.R. 192 (1940).

[94] *Halifax Mortgage Services Ltd.* v. *Muirhead* (1997) 76 P. & C.R. 418, 425-6.

the one in which he intended to place himself. Such cases can probably be explained as designed to reverse or prevent an unjust enrichment, although it is not clear that there has always been an exact equivalence between the extent of the right which the payer obtains by subrogation and the extent of the enrichment which the debtor would otherwise obtain. If it could be shown that the payer had retained property in his money, that might afford an alternative means by which he could establish a claim.

In *Banque Financière de la Cité* v. *Parc (Battersea) Ltd.*,[95] Lord Hoffmann stated that subrogation comprised two distinct institutions, namely the contractual subrogation of insurers and an equitable remedy to reverse or prevent unjust enrichment. The present writer feels that contractual subrogation, or at least "intention-based" subrogation extends to cases other than those of insurers, and includes many instances where courts have explained their decision by reference to a presumption of intention. Although the class "subrogation" as presently used probably encompasses each of the institutions referred to by Lord Hoffmann, it seems likely that still other "sets" are contained within the class. In some instances, subrogation seems to operate so as to vindicate a property right. Cases of subrogation by way of marshalling seem to defy categorisation either as a "remedy" to reverse unjust enrichment or as operating because of the intention of any party.[96] There is yet again the peculiar instance of subrogation of one paying the holders of liens on a ship, which can only take effect if the payment is made with the prior leave of a court of competent jurisdiction.[97] This category could be explained as based on the intention of the payer, but clearly intention alone is not enough in such a case, as the court's approval is required.

Substitution of one creditor for another is a legal response to a number of situations. In some cases, it occurs as a result of the intention of either or both the "new" creditor and the debtor. In others, it occurs as a legal response to a mistake made by the "new" creditor. In others, it seems to be a response to a legal policy to ensure that creditors are paid or reimbursed as fully as is possible, or that the burden of a certain loss should fall on one party, whether debtor, wrongdoer or creditor, rather than on some other party. If the response is similar in all these cases, the motivation prompting it is different.

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[95] [1998] 1 All E.R. 737, 747.
[96] Section 12.1, *ante*.
[97] See section 1.5.

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