Learning the hard way – lessons from the James Hardie case

Corporate Partner, Mark Poczman, and Corporate Lawyer, Paul Henry, discuss some practical lessons to be learnt from the James Hardie case.

On 20 August 2009, Justice Gzell of the New South Wales Supreme Court imposed severe penalties on the directors and officers of the James Hardie Group (Group) for various contraventions of the *Corporations Act 2001* (Cth) (Act) and its predecessor, the *Corporations Law* (Cth). Those penalties serve as a reminder of the high standards expected of directors and officers in the corporate governance of their companies. The purpose of this article is to highlight some of the practical lessons that can be learnt from the James Hardie case, but first we set out a brief reminder of the factual background and the penalties imposed by the Court.

Background

As discussed in our May 2009 edition, in April 2009, Justice Gzell found that James Hardie Industries Limited (JHIL) (now known as ABN 60 Pty Limited), James Hardie Industries NV (JHINV), three former executives of the Group and seven former non-executive directors of the Group had contravened corporate law.

Amongst other things, the directors and officers were found to have breached their statutory duty of care and diligence (section 180(1) of the Act). JHINV was found to have breached sections 1041H of the Act (the prohibition on misleading and deceptive conduct in relation to a financial product) and 1041E (the prohibition on making false and misleading statements).

The directors' and officers' contraventions concerned public statements, including announcements to the Australian Securities Exchange (ASX), made about the establishment and funding of the Medical Research and Compensation Foundation (Foundation). These public statements were not sufficiently qualified as to the certainty of sufficient assets of the Foundation to meet future asbestos claims. The Foundation had been established to meet asbestos claims made against the companies within the Group and its establishment was part of a substantial restructuring of the Group.

For more detail on the factual background relating to this case, please refer to the article by Dispute Resolution Partner, Anne Freeman, in the May 2009 issue of the Piper Alderman e-Bulletin. (http://s2.webtemplate.com.au/bridgehead/PiperAlderman/media/files/4630.pdf)

Applications for exoneration and penalty orders

In Justice Gzell's further judgment, his Honour considered applications by the defendants for exoneration (apart from the former chief executive officer (CEO) and JHIL who did not apply). The provisions sought to be relied upon (sections 1317S(2) and 1318(1) of the Act) provide that the Court may relieve the person either wholly or partly from a liability for contravention of a civil penalty provision, or for negligence, default, breach of trust or breach of duty, in circumstances where:

- the person has acted honestly; and
- having regard to all the circumstances of the case the person ought fairly to be excused.

His Honour found that those requirements were not met. His Honour then made orders disqualifying the defendants (other than JHINV) from the management of companies for various periods between 5 and 15 years and imposing pecuniary penalties against the defendants for amounts ranging from $30,000 in relation to the non-executive directors up to $350,000 for the CEO.

Lessons learnt

The two judgments mentioned above run to hundreds of pages and garnered considerable publicity. Given all that, what practical lessons can we take from this case?

Lesson 1 – It's not (only) what you do, it's the way that you do it

At the heart of this case was a proposed restructuring of the James Hardie Group involving a scheme of arrangement and associated transactions. The Court did not find that the restructuring itself offended company law, rather it was the communications strategy adopted that gave rise to the adverse findings against the persons and companies involved.

Lesson 2 – Facts and assumptions on which a Board bases its decisions should be properly tested

It is important for directors and officers to ensure that facts and assumptions upon which they base their decisions are thoroughly tested. This is particularly so where the decision concerns a public announcement which has potential market sensitivity or legal implications. More generally, when making decisions a prudent Board will ensure that they are satisfied as to the soundness of any inputs from senior management and will assess and take into account any qualifications made when making their decision.

Lesson 3 – Some matters shouldn't be delegated

One (US based) director said he took virtually no interest in matters relating to communication issues or strategy but would leave them to be considered by management, the attorneys and the Australian directors. His Honour found that *"[this was not] a case for reliance upon management, a co-director or an expert adviser. Management had sought the board's approval and the task of approving the Draft ASX Announcement involved no more than an understanding of the English language used in the document."*

It is stating matters too broadly to say all public statements must now be vetted by a Board, but certainly when Board input is requested by senior management, then each individual Board member should ensure they carefully and diligently consider the matter. Otherwise, we would suggest the need for Board involvement should be carefully considered when developing clear sign-off procedures for market releases, and generally, clearly the more significant or material the matter, the more important it is to have Board sign-off.

Lesson 4 – Silence at a Board meeting can constitute approval

The chairman of JHIL conducted Board meetings by consensus. He would summarise an issue and usually ask whether the Board was happy with what was proposed and people nodded or otherwise indicated their agreement by silence. Two of the directors attended the Board meeting which considered the draft announcement to the ASX by telephone. In the circumstances their silence was considered, in effect, a vote approving that draft announcement, which gave rise to a breach of duty by those directors.

This emphasises the importance of ensuring there is certainty in voting at Board meetings. If a director wishes to abstain or vote against a proposal then that director must ensure that his or her position is acknowledged and recorded. Silence may, in some circumstances, be taken as a vote in favour of a proposal.

Lesson 5 – Ensure Board papers are complete and distributed to all Board members

Two directors in the US (who attended the Board meeting by telephone) maintained that they did not have a copy of the draft announcement to the ASX and so could not have breached their duty in approving it. That argument was not accepted. Justice Gzell considered that there was clearly enough discussion to have alerted the two directors in the US to the fact that the Board was considering a document that they did not have. Their failure to ask for a copy and approval by silence was considered just as much a breach of duty as approval of the draft announcement by those who attended the meeting in person. This issue could have been avoided by those directors by simply asking for a copy of the draft announcement. Of course, better practice would have ensured that all directors had a complete set of papers without having to ask.

Lesson 6 – Keep proper minutes

Minutes are an important record of the activities of the Board. As was noted by Justice Gzell, *"One thing that has emerged clearly in this case is that recollection is fallible. If a minute is to be given evidentiary value, it ought to be a contemporaneous document, for then it is more likely to be an accurate reflection of the proceedings of the meeting rather than a reconstruction of them."*

That the issue of the effect of the (late) minutes was considered at length in the case highlights how important an item of evidence minutes can be. Therefore, as a matter of good corporate governance (and so as to comply with the statutory requirements) minutes should be finalised and entered into the minute book within one month of the relevant meeting. They should reflect that proper regard has been had by the directors to the proper discharge of their duties.

Lesson 7 – General counsel need to be mindful of their position as an "officer" of the company

Justice Gzell found that the person who served as general counsel of JHIL participated in the making of decisions that affected the whole or substantial part of the business of JHIL, and was therefore an officer (irrespective of his dual role as company secretary) and therefore subject to the duty imposed by section 180(1).

Justice Gzell considered that guarding against legal risks was at the core of the general counsel's responsibilities. His Honour found that as general counsel, it must have been obvious, or at least it ought to have been, that if JHIL authorised the release of a public statement concerning a substantial restructuring that was false and misleading, that would be harmful, or potentially harmful, to JHIL and that it was general counsel's duty to advise the Board accordingly.

As noted in our earlier article, the role taken by the general counsel of the James Hardie Group was not atypical. General counsel in similar positions need to be mindful of the obligations imposed on them as officers, and where appropriate or necessary, act robustly as required in performance of these duties.

Lesson 8 – As a director or officer, check your liability cover

Directors' and officers' insurance (D&O Insurance) policies vary considerably. They generally exclude cover for fines and penalties. The Act also prevents a company from paying premiums for a contract insuring an officer against liabilities involving a wilful breach of duty or improper use of position or information.

A company will often provide an indemnity relating to costs and liabilities arising out of the performance of their duties. However, the Act prevents companies from indemnifying an officer against certain liabilities incurred from a contravention of the Act (including certain legal costs incurred in defending or resisting proceedings).

Directors and officers (including, as applicable, general counsel) should review their liability position from time to time. To the extent the cover offered by their present D&O Insurance and company indemnity is considered insufficient, they may wish to consider supplementary personal insurance (for example, statutory liability insurance).

Takeovers Panel rewrites its procedural rules

Corporate Senior Associate, Craig Yeung and lawyer, Kylie Barrie, examine the revised rules.

The Takeovers Panel (Panel) is a review body that regulates corporate control transactions involving Australian companies, predominantly by the quick and efficient resolution of takeover disputes. The Panel announced that it has conducted a review of its Rules for Proceedings (Rules) and has posted a draft set of revised rules on its website for public consultation.

The Rules were originally adopted in November 2001 and were amended and revised in June 2004 and updated in March 2005. As part of its simplification process the Panel decided it was time to review the Rules in light of the Panel's experience over the years.

The proposed rules are a complete rewrite of the original Rules and incorporate existing Guidance Note 8 concerning matter procedures. In its announcement on 1 October 2009, the Panel indicated that if the proposed rules are adopted, Guidance Note 8 will be withdrawn.

The Panel stated in its consultation paper that the "draft has sought to identify 'rules' and 'guidance' with the aim of simplified drafting and keeping only essential rules with everything else as guidance".

The substantive changes from the existing Rules include:

- the insertion of a new rule 3.1.1(c) which imposes a 10 page limit on applications. The Panel indicated that this page limit should be sufficient for most applications
- the deletion of existing rules 5.4 - 5.7 requiring the parties to provide the Panel with ASX and other public announcements. The Panel indicated that other rules already cover the provision of relevant announcements to the Panel
- the deletion of existing rule 3.3 concerning the two business day deadline for Notices of Appearance. The Panel stated that such a deadline is not always practicable
- the deletion of existing rule 14 in relation to the need for the Panel to consent to a party's withdrawal from the proceedings. However, under new rule 3.4.1, the applicant may only withdraw its application with the consent of the Panel
- the deletion of existing rule 5.3 requiring ASIC to provide reasons for its decision within two business days where an ASIC decision is being reviewed. The Panel indicated that due to the fact the review is a de novo hearing and ASIC's practice is to provide reasons in any event as soon as practicable, the rule is no longer necessary
- the deletion of existing rules 8.3A and 13 in relation to certain procedures for giving undertakings. The Panel indicated that requests for confidential approaches and procedural fairness in relation to undertakings can be dealt with on a case-by-case basis
- existing rules 8 and 12 relating to confidentiality and media undertakings are to be included in the Notice of Appearance which is incorporated as Annexure A to the draft rules. The Panel indicated there is no need for confidentiality and media undertakings to be in both the Rules and Notice of Appearance
- the extension of the media undertaking in order to cover any application to vary the orders
- deletion of the requirement for ASIC to lodge a Notice of Appearance as it will always be a party to proceedings, whether it actively participates or not
- although the existing rule 8.5 extends confidentiality obligations to anyone who has received confidential information, the Panel proposes to introduce new rule 4.2.1 which extends the undertakings to advisers

- the insertion of new rule 2.3.2 which will require a party wishing to make a claim for legal privilege to identify:
    - the circumstances in which the advice was given
    - the subject matter or question(s) in relation to which the advice was directed.

In addition to the above, the Panel is also considering inserting a note to rule 2.3.2 as follows:

"The Panel may decline to allow the claim of privilege. *Corporations and Securities Panel v Bristile Investments Pty Limited* (1999) 152 FLR 462 decided that the privilege does not apply to the production, inspection and use of documents (or evidence) required under a direction (ASIC Reg 16) or summons (ASIC Act section 192). In *Daniels Corporation International Pty Ltd v ACCC* (2002) 213 CLR 543 the High Court did allow a claim of legal professional privilege in respect of section 155 of the Trade Practices Act 1974 (Cth)."

One of the main concerns in relation to the revised rules is the exclusion of the usual rights of parties to claim privilege over communications with their legal advisers by the specific reference that the Panel may decline a claim of privilege. The amendment, if adopted, would mean that if the Panel declines a claim for privilege, any communications between a company involved in a takeover dispute and its lawyer could be called for by the Panel. It is also likely that those communications would be made available to the other parties to the dispute and could become public. It may then have the effect of deterring a company from communicating openly and honestly with its lawyer when seeking advice.

Further consequences of the amendment may include:

- that if privilege is lost for the purposes of the proceedings before the Panel, it may also be lost for court proceedings
- any challenge by a party to retain privilege over its documents would have to be referred to a court during the Panel proceedings.

The consultation period ended on 26 October 2009 and we now wait to see whether the Panel will adopt the draft set of rules as final, or whether further changes will be made to the procedural rules. In particular, we wait to see what the Panel's approach is to the amendment regarding privilege.

High Court decision on subrogation and a first mortgagee's obligations to guarantors

The High Court's recent decision in Bofinger v Kingsway involves the law respecting sureties, their obligation to indemnify the creditor and right to indemnity by the principal debtor, and the operation of the doctrine of equity associated with the term "subrogation". The decision produces a somewhat surprising result, as Dispute Resolution Partner, Tom Griffith explains.

The facts are conveniently set out in the judgment. The Appellants (Mr and Mrs Bofinger) (the Bofingers) are husband and wife. Mr Bofinger was a director of B & B Holdings Pty Ltd (B & B Holdings), which is now in liquidation. B & B Holdings borrowed in turn from the first, second and third respondents Kingsway Group Limited, Rekley Pty Ltd and Mr John Skehan, (the first, second and third mortgagees respectively) on the security of mortgages over the same real property of B & B Holdings. The other respondents in the proceedings included the solicitors for the first, second and third respondents and certain of their directors and officers. The issues in the Appeal did not directly involve those parties.

The Bofingers gave guarantees to the first, second and third mortgagees. The guarantees were supported in each case by a mortgage over real property held by the Bofingers (not by B & B Holdings), being two properties at Caringbah, a suburb of Sydney. One of the properties was the Bofingers' family home. The Bofingers later sold these properties and applied the proceeds in reduction of the indebtedness of B & B Holdings to the first mortgagee.

B & B Holdings defaulted. The first mortgagee then exercised its power of sale over certain of the properties mortgaged by B & B Holdings. After satisfying the balance of the indebtedness of B & B Holdings, the first mortgagee accounted to the second mortgagee by payment of the surplus sale proceeds and delivery of the certificates of title and discharges of the first mortgages over two unsold properties to the second mortgagee. The first mortgagee did not, as the Bofingers contended they should have done, account to the Bofingers so that they might recoup what they had paid off the indebtedness of B & B Holdings.

The issue for the High Court was to determine who, in equity, should have priority – the Bofingers as guarantors, who had rights of subrogation in respect of B & B Holdings and the surplus in the hands of the first mortgagee after discharge of the first mortgage, or the second mortgagee, who could also fairly expect to be next in line in priority after the first mortgagee had been paid out. At first instance, and on appeal to the NSW Court of Appeal, the Court found in favour of the Respondents, including the three mortgagees. In the High Court however, the Bofingers were successful. The case warrants a closer examination of the facts.

B & B Holdings carried on business as a real estate developer. It purchased and constructed 17 townhouses and 1 house on land at Enmore, an inner suburb of Sydney. However, by February 2006, it was in liquidation. To finance the purchase of the Enmore land and the construction of the buildings on it, in 2003 B & B Holdings had borrowed $7,062,000 from the first mortgagee, Kingsway Group Limited. Then, as the project proceeded, B & B Holdings borrowed $1.4 million from the second mortgagee Rekley Pty Ltd and finally it borrowed $350,000 from the third mortgagee Mr John Skehan. The indebtedness was secured in each case by registered mortgages against the title to the Enmore land and a property held by B & B Holdings at Nullaburra Road, Caringbah.

The first, second and third mortgages were dated 31 January 2003, 14 March 2003 and 28 April 2005 respectively. In addition, by an instrument of guarantee dated 31 January 2003 (the same date as the first mortgage) the Bofingers guaranteed to the first mortgagee repayment of the amount owing from time to time under the first mortgage by B & B Holdings. The guarantee was supported by mortgages by the guarantors to the first mortgagee over residential property at Caringbah (known as the "Willarong Road property") and over a home unit in the same suburb (the “Bulwarra Street property”). Both properties were owned by the Bofingers. The Bofingers entered into instruments of guarantee on the same dates of the second and third mortgages respectively, whereby they guaranteed to the second and third mortgagees respectively repayment of the amounts from time to time owing to those parties by B & B Holdings. The guarantees given by the Bofingers to the second and third mortgagees also were secured by second and third mortgages over the Willarong Road property and the Bulwarra Street property. All three guarantees were relevantly in the same form.

There were numerous extensions to the loan agreement between B & B Holdings and the first mortgagee. It originally had an expiry date of 1 February 2004, but it was ultimately extended to 1 October 2005. B & B Holdings defaulted on the first mortgage on 1 October 2005 and on the third mortgage on 28 October 2005. It is not clear when it defaulted on the second mortgage. In July 2005, the Bofingers sold the Willarong Road property. From the proceeds, they paid a total of $894,044.14 to the first mortgagee in reduction of the amount which was then owing to the first mortgagee by B & B Holdings and secured by the first mortgage. After that, the Bofingers sold the Bulwarra Street property and on 5 October 2005 paid the first mortgagee $625,190.26. This gave a total in payments to the first mortgagee by the Bofingers of $1,519,234.40.

The Court took particular note that following the sales of the Willarong Road property and the Bulwarra Street property, there were discharges of the mortgages over those properties which the Bofingers had given not only to the first but also the second and third mortgagees. Thereafter the guarantees given by the Bofingers remained in force but were unsecured.

The Court noted that there had been no call by the first mortgagee upon the guarantees, and in that sense the payments by the Bofingers were initiated by them. However, this was in the circumstances of default by B & B Holdings. The first mortgagee was necessarily involved so as to clear the titles on two of the sales of the two properties by the Bofingers and also knew of the payment of the proceeds in reduction of the indebtedness of B & B Holdings. In November 2005 the first mortgagee went into possession of the Enmore land. On or about 2 February 2006 the first mortgagee completed the exercise of the power of sale of Lot 13 of the Enmore land. By 8 February 2006 the indebtedness of B & B Holdings to the first mortgagee had been satisfied. However, its indebtedness to the second and third mortgagees was $1,935,671.23 and $464,267.12 respectively.

On 7 February 2006, the solicitors for the second mortgagee wrote a letter to the first mortgagee with reference to the security of the Enmore land, formally requesting possession of the two remaining unsold lots (Lots 1 and 14) in the development and requesting payment of the balance of the proceeds of sale in relation to Lot 13 and the total proceeds of sale in relation to Lot 5. On the next day, the first mortgagee replied in writing consenting to the second mortgagee taking possession, enclosing the keys and discharges of mortgage in relation to Lots 1 and 14 and confirming that the balance proceeds of sale of Lot 13 (after discharge of mortgage) and the proceeds of sale of Lot 5 were to be paid to the second mortgagee’s solicitors trust account for the purpose of being disbursed to their client. The discharge of the first mortgage was subsequently registered on about 8 February 2006.

On 20 February 2006, the first mortgagee wrote to the liquidators of B & B Holdings indicating that $268,307.30 had been provided to the second mortgagee. At settlement, the letter attached a summary of receipts and payments to the first mortgagee as mortgagee in possession showing payments to the first mortgagee of $3,848,000 and the second mortgagee of $268,307, and, significantly, made an allowance for the earlier receipts from the Bofingers of the proceeds of sale of the properties. On 21 February 2006, the whole of the proceeds of the sale of Lot 5, $432,712.53, was paid to the solicitors for the second mortgagee.

The upshot was that by about 21 February 2006, or shortly afterwards, the titles to Lots 1, 5, 13 and 14 of the Enmore land no longer showed the first mortgage by B & B Holdings, and the second mortgagee had received surplus proceeds of sale of Lot 13 and the whole of the proceeds of Lot 5. The key issue then was the significance of the obligation to account to the Bofingers and its nature and scope.

All the lands that were subject of the various mortgages were land under the *Real Property Act 1900* (NSW) (the Act) and the mortgages were registered mortgages.

Section 58(3) of the Act states that the purchase money from the sale of land by a mortgagee in an exercise of power of sale shall be applied:

1. first in payment of the expenses of the sale
2. secondly in payment of the first mortgagee
3. thirdly in payment of subsequent mortgagees in order of priority
4. any surplus is to be paid to the mortgagor.

However, equity may place requirements on the mortgagee as regards the disposition of the surplus purchase monies.

The High Court's Reasoning

The High Court recognised the established principle that a first mortgagee in possession of surplus funds has a duty to account to the person beneficially entitled to the money (whether it be a second or subsequent mortgagee or the mortgagor).

The Bofingers successfully argued that they were beneficially entitled to the surplus funds after satisfaction of the first mortgage by reason of the first mortgagee's duty to account to the person to whom the surplus belonged and because of their subrogation rights.

The Court held that the first mortgagee had misapplied the surplus monies and securities following the satisfaction of the first mortgage. As a consequence, and given the loss to the Bofingers, the first mortgagee was to be treated as a constructive trustee, and to that extent it had to account to the Bofingers as a defaulting fiduciary.

Subrogation

The High Court has described subrogation in the context of a guarantee as follows:

> *Once default has occurred, the party having the benefit of the guarantee can call on the guarantor to honour his promise before calling on the principal contracting party to perform this obligation, but the guarantor, having honoured his promise, can hold the principal contracting party to account by virtue of the doctrine of the subrogation.*

The remedy of subrogation is also recognised by statute. The remedy is pursuant to section 17 of the *Mercantile Law Act 1936* (SA). In New South Wales, the relevant provision is under section 3(1) of the *Law Reform (Miscellaneous Provisions) Act 1965* which relevantly provides:

" 1. A person who, being surety for the debt or duty of another, or being liable with another for a debt or duty, pays that debt, or performs that duty, is entitled:

   a. to have assigned to that person, or to a trustee for that person, every judgment, specialty or other security held by the creditor in respect of that debt or duty, whether or not that judgment, speciality or other security is taken at law to have been satisfied by the payment of the debt or the performance of the duty, and

b. to stand in the place of the creditor and to use all the remedies, and, if necessary, and on a proper indemnity, to use the name of the creditor in any proceedings to obtain from the principal debtor or any co-surety, co-contractor or co-debtor (as the case requires) indemnity for the advances made and loss sustained by the person who paid the debt or performed the duty."

A key plank in the High Court's reasoning was an 1863 decision, *Drew v Lockett*:

> *"I am of the opinion that a surety that pays off the debt for which he became surety must be entitled to all the equities which the creditor, whose debts he paid off, could have enforced, not merely against the principal debtor but also against all persons claiming under him. It is to be observed that the second and any subsequent mortgagee is in no respect prejudiced by the enforcement of this equity; when he advances his money he knows perfectly well that there is a prior charge on the property, and if he thinks fit to advance his money on such security, it is his own affair and he cannot afterwards with justice complain. The amount being limited, it is a matter of indifference to him whether the first mortgagee or the surety is the prior claimant for that amount, and it would be, in my opinion a violation of all principle if, when the surety pays off the debt, he were not to be entitled, as against the principal debtor and those who claim under him, to be paid the full amount due to him."*

The question for the Court was who should have priority – the surety, who had materially assisted in satisfying the principal debtor's indebtedness under the first mortgage or the subsequent mortgagee (in respect of whose mortgages the principal debtor had also defaulted)?

The Court ultimately favoured the equity of the surety who was entitled to be indemnified by the principal debtor by reason of the doctrine of subrogation.

The Respondents' Arguments

The Respondents argued that the terms of the relevant guarantees given by the Bofingers displaced the Bofingers' rights of subrogation. The Court analysed the relevant clauses of the guarantees and concluded that for the subrogation rights to be excluded, clear and ambiguous words would have been required. No such words were present here. The Court also noted the general principle under Australian law that where there is any ambiguity or doubt as to the construction of a provision in a guarantee and indemnity, the ambiguity is to be resolved in favour of the guarantor, indemnifier or surety.

The Court took particular notice of the fact that the second and third mortgagees had notice of the payments made on behalf of the guarantor to the first mortgagee by reason of their consenting to the sale of the Willarong Road property and the Bulwarra Street property (over which they had security). The second and third mortgagees could have, but did not, insist on a deed of priority being entered into as a condition of their consenting to the sale of those properties. Such a deed could have displaced by contract the Bofingers' rights of subrogation. This is lesson number one from the decision.

Rejection of Court of Appeal's Reasoning

The High Court rejected the NSW Court of Appeal's reasoning whereby the Bofingers' claim for priority had been rejected.

Giles JA had based his decision on the premise that the Bofingers had undertaken obligations under the second guarantee that were inconsistent with the assertion of a prior entitlement to subrogation. The High Court rejected the contention that any inconsistency arose and found that there was nothing in the circumstances rendering it inequitable for the Bofingers to enjoy the rights of subrogation.

In the Court below, Handley AJA had analysed the Bofingers' actions by reference to estoppel by convention and applied and extended long standing authority to the effect that a mortgagor is prevented from derogating from his grant and obtaining an advantage from his breach of contract. In its analysis, the High Court noted that in order for estoppel by convention to arise, there would need to be an agreed or assumed state of facts. In this case, the particular facts required would be that there was agreement that the second morgagee had priority to the guarantors. The High Court held that no such agreed state of facts was present in this case, and no estoppel arose.

Sackville AJA appeared to start from the proposition that for subrogation to apply, it would need to displace an otherwise unconscionable or unconscientious result. This had also been the reasoning of the judge at first instance, Young CJ. The High Court answered this reasoning by reiterating that the first mortgagee's equitable duty to account for the net surplus to the Bofingers imposed on the second mortgagee rights it would otherwise have enjoyed under section 58(3) of the *Real Property Act*.

The High Court held that the first mortgagee was obliged in good conscience both to account to the Bofingers for surplus moneys and securities it held and not to undertake or perform any competing engagement in that respect without prior release by the Bofingers, and that these obligations were fiduciary in character.

The High Court ultimately held, on the limited issues before it, that the first mortgagee was liable to account to the Bofingers as a constructive trustee, and the first mortgagee was liable to pay the Bofingers equitable compensation in total $1,519,234.40 from the proceeds of sale of the Bofingers properties at Willarong Road and Bulwarra Street.

Lessons and Conclusions

It was not open for the first mortgagee to say that *"it doesn't concern me where the funds come from to reduce what's owing to me. All that matters is that the indebtedness is discharged"*. The Court in this case imposed quite strict obligations on a mortgagee in possession of surplus funds. Suggested solutions for lenders in similar situations are:

1. Enter into a Deed of Priority to cover this contingency
2. Review all potential claims in respect of the surplus funds in its hands
3. If still in doubt, either invest the money (to avoid a claim for interest foregone) or pay the money into Court. It is possible under the Trustee Acts in both NSW and SA (and presumably in other states) to pay surplus monies into Court. However, there is a rider on this, namely, a trustee who automatically pays surplus monies into Court without first making reasonable enquiries as to the person properly entitled to the funds, in circumstances where there is no reasonable doubt about the matter, may be ordered by the Court to bear the costs associated with the payment of the money into Court.

The key lesson from the Bofinger decision is that a third party paying off a principal debtor's mortgage can be presumed, unless contrary intention appears, to have intended that the mortgage be kept alive for their benefit. That is, the flip side of the indemnity that they provided to the principal debtor is that they are in turn entitled to be indemnified. That is what creates the unconscionability that founds subrogation when the first mortgagee simply assigns any surplus received by it to a second mortgagee without first making enquiries as to who is in equity entitled to those surplus funds.

Latest word from the High Court on liability for injury to a sub-contractor's employees

The High Court decision in Leighton Contractors Pty Ltd v Fox has greatly limited the responsibility of a head contractor for damage suffered by a sub-contractor's employees. Dispute Resolution lawyer, Jacqueline Rennie, explains the decision.

The Facts

Leighton Contractors Pty Ltd (Leighton) had contracted with Downview Pty Ltd (Downview) to carry out concreting work at the Hilton Hotel in Sydney. Downview had subcontracted the concrete pumping to Quentin Still and Jason Cook. Mr Still and Mr Cook engaged Mr Fox in connection with a concrete pour that was to take place on 7 March 2003.

After completion of the concrete pour it was necessary for Mr Fox and a workmate to clean the concrete pump pipes. This involved blowing an object through the pipes with compressed air. Mr Fox and his workmate moved the pipe over a waste bin. The pipe was not chained or fastened to the waste bin. Whilst they were undertaking this task, a purpose built sponge became stuck in the pipe. Mr Fox and his workmate increased the air pressure in an effort to clear the pipe. Whilst this task was being completed, the hose swung around and struck Mr Fox on the head causing considerable injury.

First Instance

At first instance it was held that Warren Stewart Pty Ltd (the company which employed Mr Fox) was solely liable for the plaintiff's injuries. It was held that there was no relevant breach of duty against Leighton and Downview.

The Court of Appeal

The Court of Appeal found that Leighton owed a duty of care to subcontractors and others coming onto their construction site within its control. It was held that the scope of this duty included *"training in matters of safety to subcontractors"*. The Court of Appeal found that Leighton would have discharged this duty by taking reasonable steps to ensure that people coming onto the worksite had undergone the relevant induction training. Ultimately, it was found that Leighton was negligent in its failure to take steps to ensure that Mr Fox undertook the relevant induction training.

The Decision of the High Court

The *Occupational Health and Safety Act 2000* (NSW) (the Act) and Regulation imposed a number of obligations on both Leighton and Downview. One of the statutory obligations relates to Leighton's requirement to provide adequate OHS training to subcontractors (section 213(1) of the Regulation). The High Court stated that the *"…objective of the site specific component of OHS induction training is the provision of information about procedures, risks and hazards that are specific to a particular workplace or site"*.

The duty which Leighton owed to Mr Fox was discussed at length. The High Court suggested that it may be accepted that Leighton, as the occupier of the site, owed a duty to persons coming onto it to use reasonable care to avoid injury. The High Court noted that the Court of Appeal "gave no consideration to whether Leighton had implemented a reasonable system for ensuring that workers coming onto the site were identified, were required to undergo site induction and were required to show evidence of completion of general work and activity based OHS induction training".

Leighton submitted that in effect the Court of Appeal had imposed upon it a duty to provide induction training to the plaintiff in the safe method of line cleaning, which forms part of the activity of pumping concrete.

The High Court held that there was no justification for recognising a duty to train. It was stated that *"If Leighton owed a duty to Mr Fox and Mr Stewart to provide induction training to them in a safe method of line cleaning, it owed a duty to provide training in a safe method of carrying on every trade and conducting every specialised activity carried out on the site to every worker on the site. There is no reason in principle to impose a duty having this scope on a principal contractor. The latter is unlikely to possess detailed knowledge of safe work methods across the spectrum of trades involved in construction work. And a duty to provide training in the safe method of carrying out the contractor's specialised task is inconsistent with the maintenance of the distinction that the common law draws between the obligations of employers to their employees and of principals to independent contractors".*

It was held that the Court of Appeal's conclusion that Leighton was negligent for failing to provide OHS training could not be sustained.

The Case Against Downview

In relation to the case against Downview, the Court of Appeal stated that *"[Downview] failed to take any steps to ensure that persons coming onto the site on 7 March [2003] underwent induction training. As a result, Mr Stewart and Mr Fox did not undergo [induction] training. … Apart from any contractual obligation to Leighton, Downview had a general law obligation to those participating in carrying out its contracting work to conduct operations safely and to do that it was obliged to contract with competent and properly trained operators. By leaving it to its own subcontractors to engage other labour and equipment, it effectively abandoned its responsibilities in that respect".*

The High Court, however, found that Downview engaged a competent contractor and had them complete the required tasks. They stated that Downview *"… was not subject to an ongoing general law obligation with respect to safety of the work methods employed by the contractor or those with whom the contractor subcontracted".*

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