SUBROGATION TO THE SECURITY RIGHTS OF THE UNPAID VENDOR AND MORTGAGEE

ORAKPO v. *MANSON INVESTMENTS LTD. AND OTHERS*

Assume a lender advances money which is used by the borrower either to purchase a property or to discharge a mortgage on his property. If the contract of loan between the lender and borrower is invalid so that the lender cannot recover his money by direct action against the borrower, may he nevertheless recover by relying on subrogation to the security rights of the unpaid vendor or mortgagee? The question was recently canvassed by the House of Lords in *Orakpo* v. *Manson Investments Ltd.*[1] The decision of their Lordships, based as it was upon reasoning completely at variance with the prevailing orthodoxy, has important implications for the role of subrogation and the extent of its operation in this context.

The facts of *Orakpo* were as follows. The plaintiff entered into eight contracts of loan with the defendants for the purpose of financing transactions which would enable him to acquire a good freehold or leasehold title to eight different properties. The defendants were licensed moneylenders and their loans were to be secured by mortgages on the properties concerned. However, as the written memorandum of the contracts did not contain all the contractual terms, the plaintiff brought an action for a declaration that the contracts were unenforceable by virtue of s. 6 of the Moneylenders Act, 1927 (U.K.) which provided that "no contract for the repayment by a borrower of money lent to him . . . by a moneylender . . . or for the payment by him of interest on money so lent and no security given by the borrower . . . in respect of any such contract shall be enforceable . . ." unless a note or memorandum in writing containing "all the terms of the contract" was signed by the borrower before the money was lent or before the security was given.

The defendants counterclaimed seeking a declaration that to the extent that the money lent had been applied to defray the purchase price or to redeem prior charges affecting the properties, they were entitled by subrogation to the security represented by the previously existing unpaid vendors' liens and charges.

At first instance, Walton, J. upheld the defendants' claim, stating that it was governed by the Court of Appeal's decision in *Congresbury Motors Ltd.* v. *Anglo-Belge Finance Co. Ltd.*,[2] the facts of which were

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[1] [1977] 3 All E.R. 1, [1977] 3 W.L.R. 229. Hereafter referred to as *Orakpo*.
[2] [1970] 3 All E.R. 385, [1971] Ch. 81.

in every material respect indistinguishable from those of the instant case.

The Court of Appeal,[3] though also bound by *Congresbury,* allowed the appeal on the ground that the counterclaim was statute barred by s. 13(1) of the Moneylenders Act. This sub-section stated that:

> No proceedings shall lie for the recovery by a moneylender of any money lent by him . . . or of any interest in respect thereof, or for the enforcement of any agreement made or security taken . . . in respect of any loan made by him, unless the proceedings are commenced before the expiration of 12 months from the date on which the cause of action accrued.

In this respect, the House of Lords concurred in the decision of the Court of Appeal. With the exception of Lord Diplock,[4] their Lordships[5] held that the counterclaim was time barred because the words "proceedings . . . for the recovery . . . of . . . money lent" in s. 13(1) were not limited to proceedings for the recovery of the debt itself but included all proceedings by which either directly or indirectly, the recovery of the money lent was sought.

Additionally, Lords Diplock,[6] Salmon[7] and Keith[8] held that the equitable charges by subrogation were securities taken in respect of the lenders' loan and therefore within the ambit of s. 13(1).

In considering the defendants' claim to subrogation, their Lordships dealt with a number of issues of general relevance. Each is discussed in turn.

I. Subrogation as a Remedy for Unjust Enrichment

The defendants' subrogation to the unpaid vendors' liens and mortgagees' charges would have prevented the plaintiff from being unjustly enriched as a result of the unenforceability of the contracts of loan. In fact, one commentator construed the judgments in the Court of Appeal in *Orakpo* as suggesting that subrogation was based on a general principle of unjust enrichment.[9]

This was rejected by the House of Lords. In particular, Lords Diplock and Salmon appeared ". . . to condemn the principles of restitution to exist as a wilderness of single instances".[10] According to

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[3] [1977] All E.R. 666. Consisting of Buckley, Orr and Goff, L.JJ.
[4] *Supra* n. 1 at 5.
[5] *Id.* Viscount Dilhorne at 11, Lord Salmon at 13, Lord Edmund-Davies at 17. Lord Keith at 22.
[6] *Id.* 9.
[7] *Id.* 12.
[8] *Id.* 17.
[9] G. Samuel, "Subrogation and Unjust Enrichment — New Feet in Old Shoes" (1977) 93 *L.Q.R.* 346.
[10] J. Beatson, "Unjust Enrichment and the Moneylenders Act" (1978) 41 *M.L.R.* 330.

Lord Salmon, the test as to whether the doctrine would be applied was entirely empirical and dependent upon the demands of justice and reason.[11] Lord Diplock said:

> . . . [T]here is no general doctrine of unjust enrichment recognized in English Law. What it does is to provide specific remedies in particular cases of what might be classified as unjust enrichment in a legal system that is based on the civil law. There are some circumstances in which the remedy takes the form of "subrogation", but this expression embraces more than a single concept in English law. It is a convenient way of describing a transfer of rights from one person to another, without the assignment or assent of the person from whom the rights are transferred and which takes place by operation of law in a whole variety of widely different circumstances. Some rights by subrogation are contractual in their origin, as in the case of contracts of insurance. Others, such as the rights of an innocent lender to recover from a company moneys borrowed ultra vires to the extent that these have been expended on discharging the company's lawful debts, are in no way based on contract and appear to defeat classification except as an empirical remedy to prevent a kind of unjust enrichment.[12]

In contrast with Lords Diplock and Salmon, Lord Edmund-Davies was prepared to allow subrogation a more expansive operation. His Lordship observed that although the extent to which the right would be granted was conjectural, there was no reason for it to be confined to hitherto recognized categories.[13]

II. The Basis of Subrogation to the Unpaid Vendor's Lien and Mortgagee's Charge

It is a generally accepted proposition in English law that subrogation is an equitable doctrine.[14] In *Orakpo* Buckley, L.J. in the Court of Appeal specifically said that subrogation to the unpaid vendor's lien and mortgagee's charge was an equitable doctrine and not one that rested on contract.[15] The House of Lords held that the rights by subrogation in these circumstances arose out of the contract of loan.[16]

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[11] *Supra* n. 1 at 12.
[12] *Id.* 7.
[13] *Id.* 14.
[14] R. P. Meagher, W. M. C. Gummow, J. R. F. Lehane, *Equity: Doctrines and Remedies* (1975) at 227 citing *Morris* v. *Ford Motor Co.* [1973] 2 All E.R. 1084;*Aetna Life Insurance Co.* v. *Middleport* (1887) 124 U.S. 534; *Royal Exchange Assurance Co.* v. *Grimshaw Bros.* [1928] 2 D.L.R. 412; *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330 at 339-40.
[15] *Supra* n. 3 at 676.
[16] *Supra* n. 1 Lord Diplock at 7, Viscount Dilhorne at 11, Lord Salmon at 12, Lord Keith at 20. Though not expressly considering the question, inferential support for the proposition may be found in the judgment of Lord Edmund-Davies at 14.

Hence, contrary to the view of the Court of Appeal, it was regarded as a contractual doctrine.[17]

The consequences of this decision and its various implications are discussed in the succeeding sections of this case-note.

III. The Prerequisite to the Operation of the Doctrine

When will the rights by subrogation be available in circumstances where a lender (L) advances money to a borrower (B) who applies the money to discharge a liability to a third party (C) secured on the property of B or where L directly pays the money to C in discharge of B's liability?

In such instances, the courts have been reluctant to allow L to be subrogated to the rights of C as against B in the absence of a special relation between L and B. For if this were not so, L would have recourse to the remedy even if he were an intermeddler to whom B should not be obliged.[18]

According to Lord Cottenham in *Meux* v. *Smith,*[19] L would be entitled to the rights of the unpaid vendor if there were a contract between himself and B giving him a security over the property for his loan. Farwell, J. in *Bird* v. *Philpott*[20] cited *Meux* v. *Smith* with approval. However, on his Honour's interpretation of Lord Cottenham's judgment, L would be entitled to the security rights not only if there were evidence of a formal agreement but also if there were evidence from all the surrounding circumstances that the parties intended that L should get a security.[21]

In *Wood* v. *Connolly Bros. Ltd.,*[22] Warrington, J.[23] at first instance followed *Meux* v. *Smith* and *Bird* v. *Philpott.* In the Court of Appeal, Cozens-Hardy, M.R.[24] and Buckley, L.J.[25] while not expressly adverting to these decisions, nevertheless based their judgments partly on the fact that the lender had made the loan with the intention and upon the condition that a security would be given.

In Australia, these authorities have been followed in *De Garis* v. *Dalgety & Co. Ltd.*[26] and *Evandale Estates Pty Ltd.* v. *Keck.*[27] This prerequisite will be referred to as the inducement of a security.

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[17] One confusing aspect of *Orakpo* is though the rights by subrogation were considered to arise out of the contract of loan, Lord Salmon at 13 and Lord Edmund-Davies at 16 speak of it as an equitable doctrine.

[18] *Falcke* v. *Scottish Imperial Insurance Co.* (1886) 34 Ch. D. 234.

[19] (1840) Sim. 410 at 427.

[20] [1900] 1 Ch. 822.

[21] [1912] 2 Ch. 25.

[22] [1912] 2 Ch. 25.

[23] *Id.* 28.

[24] *Id.* 30-1.

[25] *Id.* 31.

[26] [1915] S.A.L.R. 102 at 154.

[27] [1963] V.R. 647 at 652. In this case, Hudson, J. at 652, unlike Buchanan, J. in *De Garis* v. *Dalgety Co. Ltd. supra* n. 26, took a view similar to that of Farwell, J. in *Bird* v. *Philpott supra* n. 20.

The principle has similarly been applied in cases involving the discharge of a prior security. In *Butler* v. *Rice*[28] and *Commercial Bank* v. *Chandiram*,[29] L was held to be subrogated to the rights of the discharged mortgagee because he had made the advance on the understanding that the mortgagor would grant a specific security upon paying out the prior charge.

In *Orakpo*, however, the House of Lords held that the prerequisite to the operation of the doctrine was a contractual term that the money lent by L to B be applied in the discharge of a secured liability to C.[30] Lord Diplock considered that the right to subrogation was itself a contractual term, implied from the term that the loan moneys be applied to discharge the security.[31] By comparison, Lord Keith[32] and Salmon,[33] together with Viscount Dilhorne,[34] took the view that the right to subrogation was not an implied term of the contract but arose by operaton of law.

Regrettably, there is no direct authority on this point. Lord Diplock, however, relied upon *Wylie* v. *Carlyon*.[35] This case was also cited by Lord Edmund-Davies when he warned that the doctrine must not be loosely applied.[36]

In *Wylie* v. *Carlyon*, *Eve*, J., in declining to allow subrogation, said:

> An individual who advances money to another for the purpose of enabling that other to pay specific debts does not in the absence of a special bargain thereby acquire the rights of the persons whose debts are discharged out of his moneys against the property of the debtor.[37]

Unfortunately, it is not altogether clear from the context of these remarks what this "special bargin" entailed. It may be argued that it referred to a contractual intention as to purpose, but it is equally plausible that it referred to the inducement of a security because, on the facts, neither were present.

Furthermore, the House of Lords chose not to justify its requirement of the contractual term as to purpose. Indeed, it is difficult to understand why attention was focused on this condition and no regard was had to the authorities requiring the inducement of a security. It appears to the writer that, in principle, the reasoning upon which the latter is based is to be preferred. Here, L is subrogated to the rights of

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[28] [1910] 2 Ch. 277.
[29] [1960] A.C. 732.
[30] *Supra* n. 1 Lord Diplock at 7, Viscount Dilhorne at 11, Lord Salmon at 12, Lord Keith at 20, Lord Edmund-Davies inferentially at 14.
[31] *Id.* 7.
[32] *Id.* 20.
[33] *Id* 12.
[34] *Id.* 11.
[35] [1922] 1 Ch. 51.
[36] *Supra* n. 1 at 14.
[37] *Supra* n. 35 at 63.

the unpaid vendor or mortgagee because it would be inequitable to deny him such rights given that the inducement of a security caused him to make the advance in the first place.[38] On this reasoning, subrogation is directly concerned with preventing fraud and hardship; a role which accords with the generally accepted view that subrogation is an equitable doctrine. If this is the true justification for the kind of subrogation under consideration, it is unnecessary to require that the inducement of a security be a contractual term.

In the recently published second edition of their work, *The Law of Restitution* (1978), Goff and Jones consider that the authorities would allow L to be subrogated to the security rights of C only if he intended to take a security over B's property.[38a] The authors do not appear to take into account the fact that the House of Lords in *Orakpo* held that the right to subrogation arose out of the contract of loan. But in order to integrate this decision with their statement of principle, they contend that the required intention of the lender may be inferred if the basis of the loan from L to B is that the money be used to discharge C's mortgage or to purchase C's land. [38b] It is respectfully submitted, however, that this proposition cannot derive support from their Lordships' judgments in *Orakpo*. As stated above, the right to subrogation was seen by the House of Lords to be contingent upon the existence of a term that the money be applied in a particular way.[38c] There is nothing in their Lordships' judgments warranting the inference that the importance of such a term is that it indicates an intention on the part of L to take a security in respect of his loan. Nor can Lord Diplock's remarks in *Orakpo* be treated as authority for the proposition that subrogated security rights are not available in the event of there being no intention to take security.[38d] On the contrary, subject to the discussion in the following section of this case-note, Lord Diplock may have allowed the right to subrogation even in the absence of such intention provided the contract of loan contained the requisite contractual term.[38e]

IV. The Overruling of *Congresbury* and its Implications

Having decided that subrogated rights to the vendor's lien and mortgagee's charge were based on the contract, their Lordships overruled the decision of the Court of Appeal in *Congresbury*.[39]

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[38] *Supra* n. 27 at 652.
[38a] R. Goff and G. Jones, *The Law of Restitution* (2nd ed. 1978), at 430.
[38b] *Ibid.*
[38c] *Supra* n. 30.
[38d] *Op. cit. supra* n. 38a at 430.
[38e] *Supra* n. 1 at 7-8.
[39] *Supra* n. 2.

Lords Diplock[40] and Keith,[41] with whom Lord Salmon[42] agreed, considered that as the rights by subrogation could properly be described as "security given by the borrower" within the meaning of s. 6, they were rendered unenforceable by virtue of that section.

Presumably, Lord Diplock would have disallowed the claim on the additional ground that the rights by subrogation were unenforceable because, as implied terms in the contract of loan, they had not been reduced to writing in compliance with s. 6. This being so, Lord Diplock's approach effectively obliterates the operation of subrogation in this context. In other words, any rights by subrogation, being implied terms of the contract, will necessarily be rendered unenforceable in the same way as the contract as a whole is rendered unenforceable.

At least Lords Keith and Salmon give the doctrine marginally greater scope in that they regard the rights by subrogation as arising by operation of law from a specific contractual term with the result that such rights may be enforceable independently of the contract depending, of course, on the rule of law by which the contract of loan was rendered unenforceable in the first place. Thus, according to Lord Keith, even if s. 6 had omitted the words "security given by the borrower", the subrogated rights would still have been unenforceable because their enforcement would have amounted to the enforcement of the contract for repayment of the money lent.[43]

It follows from these views, that had the contract of loan been void, as distinct from unenforceable, then regardless of which of their Lordships' approaches had been taken there could have been no rights by subrogation, there being no contract upon which such rights would rest.

In *Nottingham Permanent Benefit Building Society* v. *Thurstan,*[44] the contract of loan between the lender and borrower was void in consequence of the borower's incapacity. However, there the lender was held to be entitled to the subrogated rights of the unpaid vendor. Surprisingly, in view of what their Lordships had said in *Orakpo* in regard to the contractual basis of subrogation, no objection was made to the correctness of the decision. Rather, their Lordships, with the exception of Viscount Dilhorne, held that the Court of Appeal in *Congresbury* had been in error in placing such great reliance on *Thurstan* in arriving at its decision.[45] Lord Diplock observed that the nature of the doctrine of subrogation was such as to make it particu-

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[40] *Supra* n. 1 at 8.
[41] *Id.* 20.
[42] *Id.* 12.
[43] *Id.* 21.
[44] [1903] A.C. 6.
[45] *Supra* n. 1 Lord Diplock at 9, Lord Salmon at 12, Lord Edmund-Davies at 14 and Lord Keith at 21.

larly perilous to ". . . rely on analogy to justify applying to one set of circumstances which would otherwise result in unjust enrichment a remedy of subrogation which had been held to be available for that purpose in another and different set of circumstances".[46]

Their Lordships paid a good deal of attention to the fact that in *Thurstan,* the contract of loan was void *ab initio* and not merely unenforceable as in *Orakpo*. Accordingly, in *Thurstan* the loan agreement and the charge given under it could be treated as if they had never been entered into with the result that the borrower/purchaser had adopted a transaction of purchase effected by the lender as her agent but with the agent's money.[47] This was regarded as a classic case of subrogation to the unpaid vendor's lien.

It ought once more to be noted that the approval of *Thurstan,* expressly by Lords Keith and Salmon and tacitly by Lord Diplock, is fundamentally inconsistent with the view that rights by subrogation to the unpaid vendor's lien and mortgagee's charge arise out of the contract. Lord Keith[48] sought to justify his approval of *Thurstan* by noting that an important feature of its *ratio decidendi,* as Vaughen-Williams, L.J. mentioned, was that the lender had obtained the lien "without any contract to that effect".[49] With the greatest respect to his Lordship, this justification is surely unconvincing given that Vaughen-Williams, L.J. spoke in terms of an agency relationship which must have been tainted by the same incapacity that vitiated the contract of loan and which therefore, on Lord Keith's view, could not have been a basis for any subrogated rights.

Finaly, Lords Edmund-Davies[50] and Salmon[51] overruled *Congresbury* on the ground that, as the contract of loan was still on foot, albeit unenforceable, it would be in conflict with the policy of the money-lending legislation to allow the lenders to rely on the contract to secure their rights by subrogation since it would have enabled them to set up their own breach of s. 6 in support of their claim.

This is the most compelling reason for overruling *Congresbury* and was, in fact, the motivating force behind the other reasons posited by their Lordships. The policy of the legislation was to protect borrowers by imposing stringent requirements on moneylenders. As men of commerce, moneylenders were expected to be fully conversant with the rules and regulations attending their day to day operations. They were also expected to be aware of the consequences that flowed from their failure to observe legal formalities. The legislation deliberately placed a heavy onus upon them and it was not for the

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[46] *Id.* 7.
[47] [1902] 1 Ch. 1 *per* Vaughan-Williams, L. J. at 9.
[48] *Supra* n. 1 at 21.
[49] *Supra* n. 47 at 9.
[50] *Supra* n. 1 at 16.
[51] *Id.* 13.

courts to circumvent this policy by allowing the lender to be subrogated to the unpaid vendor's lien and mortgagee's charge.[51a]

V. Further Implications of Contractual Intention as a Prerequisite to the Operation of the Doctrine

In most cases the outcome will be the same irrespective of whether the contract or the inducement of a security is adopted as the prerequisite for subrogation. Either both elements will be absent, as in *Wylie* v. *Carlyon*[52] or both will be present, as in *Orakpo* itself. But in some exceptional cases the theoretical dispute will have practical consequences. One such case has already been adverted to. If the contract of loan is void, it ought to follow that subrogation is impossible unless the right to subrogation is non-contractual. The House of Lords resisted this logic, but unconvincingly. Another exceptional situation is a follows. Suppose a purchaser of land by arrangement with his bank increases his overdraft expressly for the purpose of buying a house, but without offering any security, and applies the money so drawn in the purchase. If the contract upon which the overdraft is founded is unenforceable and if the borrower is declared bankrupt, could the bank claim a security by subrogation, thereby taking priority over unsecured creditors of the borrower. An application of their Lordships' decision in *Orakpo* may result in the bank being subrogated to the unpaid vendor's lien. However, this would be unfair because the bank would then be getting more than it bargained for to the prejudice of the unsecured creditors of the borrower.

VI. Relevance of the *Wrexham* Line of Authorities

In *Orakpo,* Lord Diplock referred in passing to "the rights of an innocent lender to recover from a company moneys borrowed ultra vires to the extent that these [had] been expended on discharging the company's lawful debts".[53] His Lordship had in mind the *Wrexham* line of authorities.[54] It has been suggested that these cases are relevant in factual situations such as those in *Orakpo* and *Congresbury*.[55]

In these cases the lender seeks to recover the apparently irrecoverable sum by taking advantage of a claim which would have been made

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[51a] Goff and Jones (*op. cit. supra* n. 38a at 42) note that from the point of view of policy, the decision of the House of Lords in *Orakpo* that *Thurstan* was correctly decided is anomalous. The policy of the Infants Relief Act is stronger than that of s. 6 of the Moneylenders Act and it was for this reason that the loan to the infant was void *ab initio*. Yet, as the law presently stands, he can be subrogated to an unpaid vendor's lien while a moneylender who falls foul of s. 6 cannot.

[52] *Supra* n. 35.

[53] *Supra* n. 1 at 7.

[54] *Re Wrexham Mold & Connah's Quay Railway* [1899] 1 Ch. 440, *Re Cork & Youghal Railway* (1869) L.R. 4 Ch. App. 748, *Baroness Wenlock* v. *River Dee Co.* (1887) 19 Q.B.D. 155. Other situations considered in Goff and Jones, *op. cit. supra* n. 38a at 442-445.

[55] P. Birk, "Restitution by Subrogation" (1971) 34 *M.L.R.* 208.

on the borrower by a third party, had the third party not been paid off by borrower with the money advanced by the lender. This is precisely what the lenders were seeking to do in *Orakpo*. This is to be contrasted with subrogation proper, the best exemplification of which is insurance payments. Here the plaintiff seeks not to attack the payee from the position of a third party but to assume the position of the payee thereby reducing the cost to himself of having made the payments by taking over any rights by which the payee may have recovered the sum had it not been paid by the plaintiff.[56]

Although the *Wrexham* authorities appear to support a claim to subrogation, Rigby, L.J.,[57] in the principal case said the right which enabled the plaintiff to recover had "very little if anything at all" to do with subrogation. Similarly, Lord Lindley, M.R.[58] remarked that reference to subrogation theory was unnecessary.

The consequence of the distinction was illustrated by *Wrexham* itself. Although the plaintiff was allowed to stand in the place of those creditors paid off with the borrowed money, he could not take advantage of securities and priorities to which the paid off creditors had been entitled. In other words, the substitution was imperfect.

Lord Linley, M.R.[59] and Rigby, L.J.[60] reasoned that to hold otherwise would have enabled the plaintiff, who was an unsecured creditor, to be in a better position than he could have occupied had his loan been directly enforceable against the borrower.[61] This clearly influenced Oliver, J. in *Paul* v. *Speirway Ltd. (in liquidation)*[62] in concluding that where the intention of the parties is to create an unsecured loan, there is no room for subrogation to the unpaid vendor's lien.

In *Orakpo,* the House of Lords made no distinction between subrogation proper and this right akin to subrogation. Further-

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[56] *Id.* 208-9.
[57] *Supra* n. 54 at 455.
[58] *Id.* 447.
[59] *Supra* n. 54 at 447.
[60] *Id.* 455.
[61] In the first edition of their work, *The Law of Restitution* (1964), Goff and Jones, in accordance with the comments of Lord Lindley, M.R. and Rigby, L.J. in *Wrexham,* label the right that was there granted "a right akin to subrogation" (Ch. 28). In the second edition, however, they consider that the remedy granted in these cases should be subsumed under the rubric of subrogation (*op. cit. supra* n. 38a at 409, 434 and 445). They maintain that the Court of Appeal in *Wrexham* was correct in rejecting the lender's claim to full subrogation but that there was no need, in allowing the lender a personal claim, to create an independent personal claim in equity, akin to the paid off creditor's personal claim against the borrower at law. Goff and Jones argue that the authorities have allowed a lender to be subrogated either to a personal claim (*Marlow* v. *Pitfield* (1719 1 P. Wms. 558) or to a lien (*Thurstan, supra* n.44), with the facts of each case determining the appropriate remedy. Clearly, on the facts in *Wrexham* the appropriate remedy was to allow the lender to be subrogated to the paid off creditor's personal claim against the borrower. The Court could therefore have dealt with the lender's claim within the framework of subrogation.
[62] [1976] 2 All E.R. 587 at 598.

more, the *Wrexham* authorities were ignored. In all probability, this was due to the facts in *Orakpo* which in no way illuminated the consequences of the distinction. There the lenders had bargained for a security and their claim to subrogation would have put them in no better position than they would have been in had their security been enforceable. But consider our earlier example of the unsecured bank overdraft. If the *Wrexham* line were followed, the bank would be permitted to step into the shoes of the vendor — to use the language of subrogation. However, it would have no right to the unpaid vendor's lien but would merely rank as an unsecured creditor. This is a fair solution and is to be preferred to that which may be arrived at by an application of their Lordship's decision in *Orakpo*.

Lord Salmon, at least, seemed to have in mind considerations similar to those expressed in *Wrexham,* when he stated that it would have been "absurd" to grant the lenders the security rights by subrogation as it would have enabled them to insist on repayment of the loan immediately upon the borrower's receipt of the money instead of allowing the borrower twelve months as the original contract of loan stipulated.[63] The great difficulty with this proposition is that virtually all contracts of loan will contain terms which a full subrogation to the unpaid vendor's lien will defeat. If this is a ground for refusing the remedy, Lord Salmon is, in effect, denying the possibility of subrogation in all but a very few circumstances.

No doubt, there would be no reason for his Lordship's concern if the suggestion of Hudson, J. in *Evandale Estates Pty. Ltd.* v. *Keck*[64] were adopted that the terms and conditions of the lien to which the lender seeks to be subrogated be the same as those of the loan. But Hudson, J. regarded subrogation as an equitable doctrine.[65] Therefore, such a limitation was consistent with the role of subrogation in preventing fraud and hardship. These equitable considerations had no place in Lord Salmon's judgment; subrogation in these circumstances being contractual in origin. Thus, his Lordship may have found it difficult to justify the limitation of subrogated rights in this way.

Moreover, Samuel[66] criticises Lord Salmon for failing to distinguish between a contractual and restitution obligation. He maintains that whilst the former arises out of the agreement, the latter focuses on the debt itself and requires the defendant to repay the money because it would be unconscionable for him to profit from the transaction. Therefore, to rely on the contractual obligation as a reason for denying the rights by subrogation sits incongruously with the whole

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[63] *Supra* n. 1 at 13.
[64] *Supra* n. 27 at 648.
[65] *Id.* 652.
[66] G. Samuel, "Subrogation and Unjust Enrichment: Old Feet Back in Old Old Shoes" (1977) 93 *L.Q.R.* 496.

basis of the dispute which stems from the borrower's declaration that there will be no repayment at all.

VII. Waiver of the Rights by Subrogation

The judgments of Lords Edmund-Davies and Salmon are also important in elucidating the circumstances in which the security rights by subrogation may be said to be waived by the lender or caused to merge in a higher ranking security.

In *Capital Finance Co. Ltd.* v. *Stoke*,[67] the Court of Appeal held that the vendor's acceptance of charges which subsequently became invalid for want of registration under s. 95 of the Companies Act, 1948, caused him to abandon his unpaid vendor's lien because with the completion of the contract he had got all he had bargained for.[68]

It was argued in *Congresbury*[69] that the lender's acceptance of the unenforceable mortgage given by the borrower similarly caused the waiver or merger of the lien. This was rejected by the Court of Appeal which held that the statutory provisions which rendered the mortgage unenforceable also operated to prevent the mortgage from vitiating the lien and disentitling the lender from relying on his remedy by subrogation.

Coptic v. *Bailey*[70] affirmed and further extended *Congresbury*. Here the defendant purchased property with the help of a loan from T.I. Ltd. which was secured by a legal charge on the property. Two years later, the defendant negotiated a new mortgage from the plaintiff and applied the money to pay out T.I. Ltd's mortgage. As it happened, the new mortgage, unlike the first, was unenforceable under the Moneylenders Act, 1927. Whitford, J. held that the plaintiff was entitled to be subrogated to all the rights of the first mortgagee and this included its rights by subrogation to the unpaid vendor's lien.[71]

Therefore, the equitable security was seen to be subsisting concurrently with the valid first mortgage, a view that was clearly contrary to the Court of Appeal's decision in *Capital Finance Co. Ltd.* v. *Stoke*.

Walton, J. in *Burston Finance Ltd.* v. *Speirway Ltd.*,[72] criticised the decision in *Coptic* as being "wholly out of line with all other authorities"[73] and for failing to draw a distinction between securities valid at inception and those that were not.

His Honour relied upon this distinction to reconcile *Stoke* with *Congresbury* holding that there is no waiver if the security is void (*Thurstan*) or uneforceable (*Congresbury*) at its inception, but there

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[67] [1968] 3 All E.R. 625.
[68] *Id.* 630 *per* Harman, L.J.
[69] *Supra* n. 2 at 390.
[70] [1972] Ch. 446.
[71] *Id.* 454.
[72] [1974] 3 All E.R. 735.
[73] *Id.* 742.

is waiver if the security, though initially good, subsequently becomes invalid as in *Stoke* and *Burston* itself.[74]

In *Orakpo* Lord Edmund-Davies made no reference to this distinction, holding that the facts in *Stoke* were essentially indistinguishable from those in *Congresbury* and that the latter had been wrongly decided.[75] Accordingly, his Lordship held that the plaintiff had waived any entitlement to be subrogated to the security rights. In this regard, Lord Salmon's speech was to the same effect.[76] Notably, however, both of their Lordships placed special emphasis on the fact that the unenforceability of the mortgage arose in consequence of the lenders' failure to comply with s. 6. Lord Diplock, on the other hand, expressly left open the question as to whether the equitable rights by subrogation merged in the higher ranking unenforceable security and without mentioning *Coptic,* disapproved of the principle enunciated therein.[77]

In summary, the position as to waiver appears to be as follows: where the lender has been promised a security, the rights by subrogation will only arise, subject of course to the terms of the contract of loan, if that security is not executed, or if executed, is void or unenforceable at its inception — the invalidity in no way being due to the fault of the lender.

CONCLUSION

Underlying the House of Lords' unanimous rejection of the lenders' claim to subrogation was the important policy consideration that as the moneylending legislation was a penal statute it should be construed strictly and against the interests of the moneylender who had been in breach of its terms even if such a construction caused the borrower to be unjustly enriched as a result of the transaction.

Unfortunately, in achieving this objective, their Lordships held that the doctrine of subrogation to the unpaid vendor's lien and mortgagee's charge was contractual in origin. This has severely curtailed its operation for in their Lordships' views there will be few circumstances in which the remedy will be granted even in the absence of strong policy considerations requiring its denial.

If taken to its logical conclusion, Lord Diplock's aproach would effectively rule out the possibility of this kind of subrogation because the factor that vitiates the contract of loan must also vitiate any rights by subrogation.

Lords Keith and Salmon, together with Viscount Dilhorne, are slightly more lenient because, on a logical extension of their view, rights by subrogation may be available if the contract is unenforceable,

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[74] *Id.* 738 and 742.
[75] *Supra* n. 1 at 16-17.
[76] *Id.* 3.
[77] *Id.* 8.

though not if void. But this limited availability is further restricted when one considers that the subrogated rights may be waived when a promised security is given even though that security is, through the lender's fault, unenforceable.

Additional difficulties arise in situations where the requisite contractual intention exists but there is no inducement of a security. In these instances, a strict aplication of their Lordships' decision in *Orakpo* would result in a solution which is decidedly unfair. It would seem preferable to resolve the difficulties by reference to the analogous *Wrexham* line of authorities.

It is submitted that the House of Lords could have achieved its objective by adopting the generally accepted proposition that subrogation is an equitable doctrine and that its operation in this context was dependent upon the inducement of a security, but that the lenders had waived their subrogated security rights by accepting mortgages which, though unenforceable, were unenforceable in consequence of their breach.

Had their Lordships so held, *Orakpo* would have accorded with the preponderance of authorities in this area and the role of subrogation to the unpaid vendor's lien and mortgagee's charge in preventing unjust enrichment in the absence of counterveiling policy considerations would have been preserved. One hopes that *Orakpo* will not cause Australian courts to abandon the more orthodox attitude that they have hitherto exhibited.

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