THE DUTY OF MORTGAGEES WHEN EXERCISING THE POWER OF SALE IN VICTORIA

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The decision of Mr Justice Murphy, of the Victorian Supreme Court, in *Goldcel Nominees Pty Ltd v. Network Finance Ltd*[1] raises issues of significance for solicitors acting on behalf of mortgagees exercising their powers of sale of mortgaged property. Not only does the *Goldcel* case deal with the duty owed by mortgagees, but during the course of his judgment Murphy J. carefully scrutinized the actions of the mortgagee's solicitor. The judgment, therefore, is of importance as a reminder to solicitors that their duty, in certain circumstances, may extend beyond acting solely in the interests of their clients.

The purpose of this article is to examine the decision in the *Goldcel* case in the context of section 77 of the Transfer of Land Act 1958 (Vic.) which provides, *inter alia*, that a mortgagee selling the mortgaged property must act in good faith, and have regard to the interests of the mortgagor.

To place the case in context it will be necessary first to refer to the duty of a mortgagee at common law. In so doing, an examination will be made of the various English and Australian decisions of relevance in this area.

Finally, an analysis will be made of the implications of the *Goldcel* case, and an attempt made to point out various matters which a mortgagee should have regard to when exercising the power of sale.[2]

A. *THE DUTY OF A MORTGAGEE IN ENGLAND*

Prior to the decision of the Court of Appeal in *Cuckmere Brick Co. Ltd v. Mutual Finance Ltd*[3] there was a conflict among the various authorities as to whether a mortgagee's duty was only to act in good faith, or if liability could also attach if the mortgagee exercised the power of sale in a negligent manner.

The courts have recognized that a mortgagee is not a trustee for sale. Unlike a trustee, who acts on behalf of others and is liable for negligent acts, a mortgagee has a substantial interest in the property being sold.[4] The power of sale is given to the mortgagee for the purpose of realizing his security.[5]

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1 [1983] 2 V.R. 257; hereinafter referred to as the *Goldcel* case. The decision is referred to in a case note by Maher, L.W., (1983) 57 *Law Institute Journal* 806.

2 An excellent article, which relates to the Queensland context but is also relevant to Victoria is Vann, R.J., 'The Mortgagee's Duty on Sale in Queensland' (1981) 6 *Queensland Lawyer* 135.

3 [1971] 1 Ch. 949. A detailed discussion of that case and other authorities will be found in Butt, P., 'The Mortgagee's Duty on Sale' (1979) 53 *Australian Law Journal* 172; Tyler, E. L. G., 'Enforcing Mortgage Securities' (1981) 55 *Australian Law Journal* 559; Francis, E. A., *Mortgages and Securities* (1975); Croft, C. E., *The Mortgagee's Power of Sale* (1980); and Sykes, E. I., *The Law of Securities* (1986).

4 See Tyler, *op. cit.* 562.

5 A strong proponent of this view is Palmer, K. J. in a letter to the editor (1980) 54 *Australian Law Journal* 436.

Early cases such as *Warner v. Jacob*[6] and *Kennedy v. De Trafford*[7] held that a mortgagee's duty was to act in good faith. In the latter case Lord Herschell, after expressing this view, said:

> It is very difficult to define exhaustively all that would be included in the words 'good faith', but I think it would be unreasonable to require the mortgagee to do more than exercise his power of sale in that fashion. Of course, if he wilfully and recklessly deals with the property in such a manner that the interests of the mortgagor are sacrificed, I should say that he had not been exercising his power of sale in good faith.[8]

On the other hand, the Privy Council formulated the mortgagee's duty differently in *McHugh v. Union Bank of Canada*.[9] That case involved the seizure of horses by a bank, exercising its powers under a chattel mortgage. Some of the horses were suffering from disease, so the bank arranged for them to be dipped. Subsequently, the horses were driven hurriedly to Calgary, some 55 miles from the mortgagor's farm. Some of the horses died and others lost their condition.

In affirming the trial judge's finding of negligence, Lord Moulton said:

> It is well settled law that it is the duty of a mortgagee when realizing the mortgaged property by sale to behave in conducting such realization as a reasonable man would behave in the realization of his own property, so that the mortgagor may receive credit for the fair value of the property sold.[10]

Reference should also be made to *Tomlin v. Luce*[11] where a first mortgagee was held liable for the negligence of his agents, who had misdescribed the property offered for sale, with the result that the purchasers were allowed 895 pounds compensation.

So far as English law is concerned the conflict appears to have been settled in favour of recognizing a duty founded in negligence by the Court of Appeal in *Cuckmere's* case.[12] The plaintiffs were the owners of the land, for which they had planning permission to erect 35 houses. They also had permission to erect 100 flats. Upon default, the defendant mortgagees took possession of the land, and instructed agents to sell it at public auction. No mention was made in subsequent advertisements of the planning permission for flats. The mortgagors drew that fact to the attention of the mortgagees, and requested that the sale be postponed. The defendants refused to do so, but instructed the auctioneers to mention the existence of the planning permission relating to the flats at the auction.

At trial, the defendants were unable to produce any expert witness who was willing to testify that it was reasonable to omit reference to the planning permission for the flats in the advertisements.[13] It was clear, therefore, that their conduct was more than simply an error of judgment, and that prudence would have dictated the postponement of the auction.

6 (1882) 20 Ch. D. 220.
7 [1897] A.C. 180.
8 *Ibid.* 185. Readers are referred to Butt's analysis, *op. cit.* 175 of *Kennedy v. De Trafford*. It should be noted, however, that both Croft and Tyler, *op. cit.* 563-4 disagree with Butt's conclusion that Lord Herschell's judgment does not exclude the possibility of a mortgagee being liable for negligence.
9 [1913] A.C. 299.
10 *Ibid.* 311.
11 (1889) 43 Ch.D.191.
12 *Supra*.
13 Referred to at 964 of Lord Justice Salmon's judgment.

After referring to the principle that a mortgagee is not a trustee, Lord Justice Salmon, who delivered the leading judgment, held that in exercising his power of sale, a mortgagee owes a duty to take reasonable precautions to obtain the true market value of the property. *Kennedy v. De Trafford* was distinguished on the basis that Lord Herschell, in that case, was of the view that the acts of the mortgagee were not negligent, and he therefore did not need to consider that question. Moreover, the House of Lords had not considered *Tomlin v. Luce*. Salmon L.J. concluded that a mortgagee and mortgagor were in a sufficiently proximate position to be considered neighbours under *Donoghue v. Stevenson*.[14]

Cross L.J. held that, in the confused state of authorities, he was not bound to follow *Kennedy v. De Trafford*. His Lordship referred to *McHugh's* case as support for the negligence test. Counsel for the defendants, Mr Vinelott Q.C., as he then was, sought to distinguish the decision of the Privy Council, on the basis that it related to the duty of care owed in dealing with the mortgaged property. This distinction was criticized as being illogical, his Lordship stating that there was no reason why the duty should change, and a mortgagee escape liability if he acted in good faith, however negligent he might be.[15] The final judgment, that of Cairns L.J., referred to the conflicting authorities which were not capable of being reconciled satisfactorily. His Lordship concluded that, on balance, the correct view was in favour of the negligence style test.

Cuckmere's case has been recently followed by the Privy Council in *Tse Kwong Lam v. Wong Chit Sen*,[16] on appeal from the High Court of Hong Kong. Put simply, the facts involved a sale by a mortgagee at auction to a company in which the mortgagee and his family held all the shares.[17]

The Board held that there was no breach of the rule that a mortgagee cannot sell to himself. However, it went on to say that the circumstances were such that a court would scrutinize the transaction carefully.

Lord Templeman stated that a sale could only be upheld if it were shown that reasonable precautions had been taken to obtain the best price reasonably obtainable at the time of sale. His Lordship went on to say that an auction which provides only one bid is not necessarily the best indication that the true market value of the property has been achieved.

Criticism was also levelled at the mortgagee because it had not sought expert advice as to the best method of realizing the property, relying solely on the statement of a solicitor's managing clerk to proceed at auction. In addition, the mortgagee had not allowed sufficient time for advertising (some 15 days only) for a property worth approximately HK$1.2m. Further, the relationship between

[14] Meagher, R. P., Gummow, W. M. C., and Lehane, J. R. F., *Equity: Doctrines and Remedies* (1984), 51-2 criticize the decision in *Cuckmere*'s case as overlooking the fact that a mortgagor's rights arise in equity, pursuant to the right of redemption, and not at common law. A similar view was adopted by Zelling J. in *Citicorp Australia Ltd v. McLoughney* (1983) 35 S.A.S.R. 375. Whilst this approach may be conceptually correct, it is submitted that there is no reason why the law cannot adapt to take into account the need for compensation in appropriate cases.

[15] But see the views of Tyler, *op. cit.* 566.

[16] [1983] 3 All E.R. 54, referred to in Sykes, *op. cit.* 114.

[17] Compare with *A.N.Z. Banking Group Ltd v. Bangadilly Pastoral Co. Pty Ltd* (1978) 52 A.L.J.R. 529, discussed later in this article.

the mortgagee and the purchaser was such as to make the purchaser aware of the reserve placed on the property.

The above authorities strongly suggest that in England, and jurisdictions where Privy Council decisions remain the ultimate authority, the conflict has been resolved in favour of the negligence style test.[18]

B. *DECISIONS OF THE HIGH COURT*

The most important early decision of the High Court dealing with the duty of a mortgagee is *Pendlebury v. Colonial Mutual Life Assurance Society Ltd.*[19] The case involved the auctioning of farm property situated in the Mallee, some 235 miles from Melbourne. The land was worth 2000 pounds, but was sold for 720 pounds, the auction having been conducted in Melbourne.

The main criticism by the mortgagor related to the insufficiency of advertising. The mortgagee had not advertised in newspapers circulating in the Mallee area, and only a few advertisements had been placed in the *Age* and *Argus* in Melbourne.

Moreover, there were a number of important omissions in the advertisements. No reference was made as to the exact location of the property, nor to the quality of the soil or other attributes, apart from giving title particulars and stating that the property was well fenced and watered, and had useful buildings.

The trial judge had found in favour of the mortgagee on the basis that it had acted honestly. The High Court reversed that decision. Griffith C.J. was of the view that a mortgagee must not act recklessly, nor wilfully sacrifice the interests of the mortgagor. Referring to the inadequacy of the advertising, the Chief Justice said:

> It is not disputed that some advertisement was necessary. In my opinion, the object of a sale by auction is to secure a fair price for the property offered by means of competition between probable purchasers. And the object of giving public notice of a sale by auction, whether by advertisement, bellman, posters or otherwise, is to bring the subject of the sale to the notice of such probable purchasers, and so to induce such competition as will be likely to secure a fair price.[20]

Barton J. also held that the mortgagee had acted in disregard of the mortgagor's interests. The judgment of Isaacs J. is of significance because he specifically rejected the notion that the word 'reckless' could include mere negligence or carelessness in carrying out the sale. Nevertheless, in his Honour's view the mortgagee had failed to act in good faith and had disregarded the interests of the mortgagor.

Although there are some High Court decisions subsequent to *Pendlebury's* case which contain *dicta* of relevance,[21] the next important case is *Forsyth v. Blundell.*[22] The facts are set out in the headnote as follows.[23] Pursuant to a power of sale of land, a mortgagee arranged for an auction to be held with a reserve of $120,000, which was the amount of the mortgage debt. Before the date fixed for auction, XL expressed to the mortgagee its interest in paying out the mortgage

[18] See Butt, P., 1984 *Annual Survey of Australian Law* 34.
[19] (1912) 13 C.L.R. 676.
[20] *Ibid.* 683.
[21] Butt's article *op. cit.* examines these decisions at pp. 177-8.
[22] (1973) 129 C.L.R. 477.
[23] The decision of Fox J. in the Court below is reported at (1971) 19 F.L.R. 17.

debt, or of bidding up to $150,000 at auction. The mortgagee then sold the land privately to Shell for $120,000, without informing Shell of the interest which had been indicated by XL, or XL of the offer made by Shell.

The majority of the Court, Walsh and Mason JJ., found that the mortgagee had acted with 'calculated indifference' to the mortgagor. Neither Justice considered it necessary to consider whether a mortgagee's duty extended to negligent acts.

The dissenting Justice, Menzies J., was of the opinion that the views expressed by the Privy Council in *McHugh v. Union Bank of Canada* and the Court of Appeal in *Cuckmere's* case were not at odds with the *dicta* or Lord Herschell in *Kennedy v. De Trafford*. Menzies J. said :

> To take reasonable precautions to obtain a proper price is but a part of the duty to act in good faith. This duty to act in good faith falls far short of the Golden Rule and permits a mortgagee to sell mortgaged property on terms which, as a shrewd property owner, he would be likely to refuse if the property were his own.[24]

It is instructive to refer to the argument of Charles Sparrow Q.C. for the plaintiffs in *Cuckmere's* case, where he stated that to act *bona fide* is to act reasonably. He then went on to say that a mortgagee must act fairly towards the mortgagor, and this admits an objective as well as a subjective test.[25]

It is respectfully submitted, however, that Menzies J.'s approach is not correct.[26] As Tyler[27] points out, the main difference is that the 'good faith' standard imposes only a negative duty on the mortgagee not to act in bad faith, whereas the 'reasonable care' standard imposes a positive duty to take care.

The next relevant case is *A.N.Z. Banking Group Ltd v. Bangadilly Pastoral Co. Pty Ltd*,[28] which is the subject of close analysis by an article by Peter Butt.[29] The facts are complicated, but in essence involved the sale of property by a mortgagee to a company which it controlled. The High Court held that the transaction was not a proper one, as it was not an independent bargain.

There were other aspects of the sale which were open to question, such as the reserve of $250,000, which was well below the market value of the property. Further, the auction was held two days before Christmas, a date when purchaser interest was likely to be low. As in the *Tse Kwong Lam* case,[30] which was decided subsequently, another complication was the sale to an associate of the mortgagee, with the result that the purchaser was in a position to know the reserve which had been placed on the property.

In the course of his judgment, Jacobs J. said:

> It is true that *bona fides* in this connexion is not concerned with the motive for exercising the power of sale but, once the decision to sell has been made, it is concerned with a genuine primary desire to obtain for the mortgaged property the best price obtainable consistently with the right of a mortgagee to realize his security.[31]

[24] (1973) 129 C.L.R. 477, 481.
[25] [1971] 1 Ch. 949, 955.
[26] Sykes, *op. cit.* 113 refers to the conclusion of Menzies J. as being remarkable. See also the comments of Murphy J. in the *Goldcel* case at 262. It is ironic that although Menzies J. cast a more stringent duty on the mortgagee than Walsh and Mason JJ., he disagreed with their conclusion that the mortgagee had breached his duty.
[27] *Op. cit.* 569.
[28] (1978) 52 A.L.J.R. 529.
[29] *Op. cit.*
[30] [1983] 3 All E.R. 54.
[31] (1978) 52 A.L.J.R. 529, 531.

The final decision of the High Court is *Commercial and General Acceptance Ltd v. Nixon*,[32] which involved the interpretation of section 85 of the Queensland Property Law Act 1974. That section provides that, in exercising a power of sale, it is the duty of a mortgagee to take reasonable care to ensure that the property is sold at market value.[33]

It is not necessary to deal with the facts in detail. The principal allegation related to a failure by the mortgagee's agents to properly advertise the property for sale. The trial judge had found that the local advertising was sufficient, but that the advertising in the *Courier Mail* was not. The property had only been advertised once in that newspaper, and not on a Wednesday, being one of the most popular days for real estate. Moreover, no mention was made of the location of the property, except to say that it was near Bargara. Many readers would have been unaware that this is near Bundaberg.[34]

The main issue to be decided was whether the mortgagee should be held liable for the negligence of its agents. Gibbs C.J. found it unnecessary to form a concluded opinion on the common law authorities as the duty of care required by the mortgagee in Queensland was governed by s. 85, and so far as that section was concerned that duty was clear: namely, to take reasonable care to ensure that the property was sold at market value.

After stating that the duty was not discharged by employing competent agents his Honour continued:

> A reasonable man, selling his own property by auction, and wishing to obtain the market value, would not allow the auctioneers a free hand to advertise in whatever manner they thought fit; he would make reasonable endeavours to ensure that the advertising proposed was adequate. It is not unduly burdensome to require a mortgagee to exercise similar care.[35]

Aickin J., after examining the Queensland legislation, indicated that even apart from s. 85 he would have found in favour of the mortgagor under the common law principles. That duty at general law extended to take reasonable care to obtain a proper price, and liability attached for the negligent acts of his agents. His Honour, then, was in favour of the negligence type approach.

The above discussion reveals that the High Court authorities in this area are inconclusive; in *C.A.G.A. v. Nixon*, Gibbs C.J. was of the view that they were irreconcilable.[36] However that may be, it should be pointed out that Francis concludes that the trend of decisions over the past century reveals a hardening of attitude towards a mortgagee.[37]

[32] (1981) 56 A.L.J.R. 130.

[33] S. 85 is analyzed in Vann, *op. cit.*, as is *C.A.G.A. v. Nixon*. See also the note (1982) 12 *Queensland Law Society Journal* 19; Barber, R. N., (1980) 10 *Queensland Law Society Journal* 21, and (1983) 57 *Australian Law Journal* 238, 240-1.

[34] It may not be too cynical to remark that the mortgagee's agents acted in ignorance of the requirements of *Pendlebury's* case relating to the need for proper advertising.

[35] (1981) 56 A.L.J.R. 130, 131.

[36] *Ibid.* 130.

[37] *Op. cit.* 99. Compare with Sykes, *op. cit.* who says at 112, 'It seems therefore that a higher degree of care than what in general is proclaimed in the older authorities, though still not approaching the measure of the trustee's duty, is now likely to be insisted on.'

C. *RECENT DECISIONS OF SUPREME COURTS IN THE STATES AND TERRITORIES*

In the light of the confused position of the law, Supreme Courts in States and Territories, where statutory provisions do not apply, have generally adopted the stance that they will apply the *bona fide* test, pending resolution by the High Court.[38]

In *Citicorp v. McLoughney*,[39] Zelling J. refused to follow the decision of the Court of Appeal in *Cuckmere's* case. His Honour held that a mortgagee has two duties: the first not to sacrifice the mortgagor's rights otherwise than is necessary to realize his security, the second to realize his security so to protect adequately his own interest.

Similarly, in *Cachalot Nominees Pty Ltd v. Prime Nominees Pty Ltd*,[40] Smith J., of the Western Australia Supreme Court, stated that until the High Court decides otherwise, the task of the Court was to decide whether the mortgagee 'wilfully or recklessly' sacrificed the interests of the mortgagor. The test was not to be equated with any common law concept of negligence. However, reference was made to the need for the mortgagee to take reasonable precautions to obtain a proper price.[41]

In another recent decision[42] Nader J., of the Northern Territory Supreme Court, also refused to adopt the negligence style test. Unfortunately, his Honour's judgment does not set out the mortgagor's allegations in detail, but it appears that the main complaint was the premises were sold at less than their true value. Nader J. rejected the argument that the mortgagee was in breach of duty in the following passage:

> The mortgagor has produced no evidence that the sales were not properly conducted in any relevant sense. There is no evidence that they were inadequately advertised; that they were sold on a day or at a place that ought to have been seen to be unpropitious, or that the purchasers were not completely independent of the mortgagee. Indeed, there is uncontradicted evidence to the contrary.[43]

Although State and Territorial Supreme Courts have chosen not to follow *Cuckmere's* case, mortgagees should not be complacent for a number of reasons. First, as the Editor of the Australian Conveyancing Reports[44] says, when commenting on Zelling J.'s decision in the *Citicorp* case, it is possible that the more modern English view will ultimately prevail.

Secondly, reference should be made to the views of Stone[45] that the choice as to which test is adopted is less important than at first appears. Writing in 1979,

38 *Expo International Pty Ltd v. Chant* [1979] 2 N.S.W.L.R. 820; *Brutan Investments Pty Ltd v. Underwriting and Insurance Ltd* (1980) 39 A.C.T.R. 47; *Dimmick v. Pearce Investments Pty Ltd* (1980) 43 F.L.R. 235.

39 (1983) 35 S.A.S.R. 375.

40 [1984] W.A.R. 380.

41 *Ibid.* 393. Compare this with the *dicta* of Powell J., of the New South Wales Supreme Court, in *National Commercial Banking Co. of Australia v. Solanowski* [1984] N.S.W. Conv. R. 55, referred to by Butt, P., 1984 *Annual Survey of Australian Law* 36 where his Honour said 'While mere errors of judgment do not constitute a breach of a mortgagee's duty to his mortgagor a failure otherwise to take reasonably adequate steps to ensure a sale at a fair price will constitute a breach of that duty.'

42 *Westpac Banking Corporation v. Mousellis* (1986) 37 N.T.R. 1.

43 *Ibid.* 9.

44 (1984) A.N.Z. Conv. R. 420, 421.

45 Stone, M., (1979) 53 *Australian Law Journal* 842.

she concluded that an examination of the various decisions in this area showed that in no case was the mortgagor denied relief, because the mortgagee's conduct was not regarded as reckless, but merely negligent.[46] This conclusion is echoed by a Canadian commentator, Robertson,[47] who states that the distinction between the two tests is more illusionary than real.

Finally, mortgagees will need to be aware that many of the decisions referred to above are in jurisdictions which, unlike Victoria, do not have specific statutory provisions governing a mortgagee's duty.

D. *SECTION 77 OF THE TRANSFER OF LAND ACT 1958*

Section 77 provides, *inter alia*, that if within one month after service of a notice, or such other period as is fixed by the mortgage or charge, the mortgagor does not comply with the notice, the mortgagee may *in good faith, and having regard to the interests of the mortgagor*, grantor or other persons, sell the property mortgaged or charged, together or in lots, by public auction or by private contract.

The section was first analysed by Lush J. in *Henry Roach (Petroleum) Pty Ltd v. Credit House (Vic.) Pty Ltd.*[48] His Honour concluded that the effect of s. 77 was to bring together the concepts of good faith and the obligation to exercise care, in much the same way they are blended in the dissenting judgment of Menzies J. in *Forsyth v. Blundell*, and Salmon L.J. in *Cuckmere's* case.

Lush J. went on to state that a mortgagee is entitled to give consideration first to his own interests, bearing in mind the reason for the existence of the power of sale. Thus a mortgagee is entitled to sell at the time of his choice. But a mortgagee cannot sell the property without proper advertising, and is bound to take reasonable steps to ascertain the value of the property. Nor can a mortgagee sell the property for a figure which is merely sufficient to pay the debt. These duties derive from the requirement that the mortgagee is to have regard to the mortgagor's interests.

Although Lush J. also stated that there is no longer any room to doubt what the proper test is under s. 77, with respect to his Honour, the position is not so obvious. As Croft[49] points out, the *dicta* of Menzies J. is not necessarily consistent with that of Salmon L.J.. In addition, it is not clear if s. 77 imposes a positive duty on a mortgagee to take reasonable care, as is required by the Queensland legislation.

In the *Goldcel* case, Murphy J. found it unnecessary to form a concluded opinion on this point. After referring to the words 'and having regard to the interests of the mortgagor', his Honour posed the question whether they added anything to the duty to act in good faith, and in particular if they imported an objective standard of care.[50]

[46] But see Tyler's comment, *op. cit.* 569, that one day the distinction may prove to be significant.
[47] 'Foreclosure By Power of Sale; Securing A Proper Price in New Brunswick', (1983) 32 U.N.B.L.J. 83. See also Longo, J.P., (1982) 14 *Western Australia Law Review* 513, 514.
[48] [1976] V.R. 309.
[49] *Op. cit.* 100.
[50] *Supra* 261.

For the purposes of the case before him Murphy J. said:

> . . . s. 77(1) requires that the mortgagee, on selling, must take reasonable steps to ensure that, at the time of sale, he is getting the best price then available for the mortgaged property, and reasonable steps to obtain the best price must be taken irrespective of the amount of the mortgage debt. The 'interests of the mortgagor' must in my opinion include at least his interest to see that the mortgagee takes reasonable steps to get on sale the best possible price available for his property. The mortgagee must have regard to this interest.[51]

E. *THE FACTS OF THE GOLDCEL CASE*

The plaintiff, Goldcel Nominees Pty Ltd, was a company effectively controlled by Miss Goldman. The first named defendant, Network Finance Ltd, was the mortgagee of two properties, referred to as Bali Hi and the Lilydale property, both of which were mortgaged by the plaintiff to the defendant for the sum of $265,000 and $131,000 respectively.

The second named defendant, Romalla Pty Ltd, was the eventual purchaser of Bali Hi. Romalla was under the control of Mr Friedman, a principal participant in the events which unfolded. The purchaser of the Lilydale property, Pignataro, was the third named defendant.

Another important participant was the solicitor for Network Finance, who had also acted on behalf of Friedman on various occasions.

The plaintiff alleged that the sales of Bali Hi to Friedman's company for $310,000, and the Lilydale land to Pignataro for $140,000, were at undervalue, and that more appropriate sale prices would have been in the range of $400,000 and $200,000 for each of them respectively.

Both of the properties had been scheduled to be sold at auction on 11 August, but were sold by private treaty a few days beforehand, on 6 August. Although the contracts had been entered into, no transfers had been signed before the mortgagor commenced the action. Included in the relief sought was a declaration that the contracts were void and unenforceable against the plaintiff.

It is significant that Friedman did not give evidence at the trial, nor was there any satisfactory explanation for his absence.

In analysing the conduct of the mortgagee, Murphy J. found it necessary not only to consider its actions (primarily through the conduct of its finance manager Mr Lyon) but also those of its authorized agents. These included its solicitor, who directly negotiated the sale of Bali Hi to Friedman, and Hall, an estate agent, who was involved in the sale of the Lilydale property. The conduct of these persons was considered in the light of the subjective requirement to act in good faith, and the additional obligation to have 'regard to the mortgagor's interests'.

The plaintiff, in applying to have the contracts set aside, made various allegations, including,

1) That the sale prices obtained were not the best available.
2) That the agent, Hall, in relation to the Lilydale property had in effect informed the purchaser of the reserve.

[51] *Ibid.* 261-2.

3) That the solicitor for the mortgagee had undertaken to consult Miss Goldman's solicitor before selling either of the properties privately.

Each of these matters will now be considered individually, and in addition reference will be made to other relevant issues.

F. *THE FAILURE TO OBTAIN THE BEST PRICE FOR BALI HI*

The main complaint of the plaintiff related to the failure of the mortgagee to exploit the interest shown by two potential purchasers in the Bali Hi property. One of these persons, Doobinson, gave evidence that had the property gone to auction he would have attended and bid. It should be noted that Doobinson did subsequently purchase another property owned by Miss Goldman, and that Murphy J. rejected the contention that Doobinson was not a genuine buyer ('a dummy').

In so far as the other potential purchaser Rotheray Gair was concerned, he had at one stage made an offer to purchase Bali Hi through an intermediary for the sum of $295,000 on a 60 days settlement. The facts in some respects on this point, therefore, resembled those in *Forsyth v. Blundell*.

In the light of the evidence, Murphy J. found that the sale of Bali Hi for $310,000, shortly before auction, could not be justified. His Honour was not satisfied that a sufficient effort had been made to take advantage of the interest which had been shown by Doobinson and Gair.

The mortgagee's solicitor had informed Rotheray Gair's representative, a Mr Harle, of the pending sale to Friedman for $310,000, but had placed an unreasonable requirement that a better offer be indicated within 20 minutes. No satisfactory explanation was given for the imposition of this time limit, which was regarded as being 'ridiculous'.

Moreover, having regard to the previous negotiations with interested parties, Murphy J. concluded that the auction should have proceeded. His Honour said:

> There were no reasons advanced sufficient to satisfy me that the negotiations should not have continued or that the property should not have gone to auction. In not proceeding further and in not even allowing Harle sufficient time to contact Rotheray Gair and in cancelling the auction and completing the private sale to Friedman, it could not be said that the mortgagee obtained the best price available at the time.[52]

Murphy J. referred to the evidence of valuers which was inconclusive, the most satisfactory valuation being for the sum of $350,000. His Honour said that this would have supported the sale price, in the absence of the various matters alleged by the plaintiff, but those matters led him to the conclusion that the sale was not *bona fide*.[53]

G. *THE FAILURE TO OBTAIN THE BEST PRICE FOR THE LILYDALE PROPERTY AND DISCLOSURE OF THE RESERVE*

In relation to the Lilydale property, which had been sold for $140,000 to the third named defendant, Pignataro jnr, the evidence revealed that his father,

[52] *Ibid.* 275.
[53] *Ibid.* 277.

Pignataro snr, had leased the land and had at one stage toyed with the idea of paying $200,000. There was a crop of strawberries on the property which was yet to mature, and Mr Pignataro snr had rushed back from an overseas trip when informed by his son that the property was up for sale. This led to the finding that the third named defendant was an anxious purchaser.

Yet the evidence disclosed that the estate agent handling the transaction, Hall, told Pignataro snr that if he were prepared to increase a previous offer to $140,000, this would probably be sufficient to enable him to buy the property.

Furthermore, Murphy J. was satisfied that Pignataro jnr would have attended the auction and bid, and that a figure of $200,000 would not have been entirely out of the question, bearing in mind the stake he and his father had in the property. As his Honour said, 'I am satisfied that it should have been obvious to the mortgagee that it was likely that he would have paid more than $140,000 at auction.'[54]

H. *THE FAILURE TO INFORM THE MORTGAGOR'S SOLICITOR PRIOR TO SALE*

Another matter relied on by the mortgagor was that the mortgagee's solicitor had given an undertaking not to sell the properties without first consulting the mortgagor's solicitor, Mr Cooper.

It was found that an undertaking had been given to inform Mr Cooper as opposed to consulting him. The significance of this evidence was that Miss Goldman had been negotiating to sell Bali Hi for approximately $400,000, which was an amount well in excess of the sale price to Friedman.

The deliberate breach of the undertaking was also important in assessing the allegation of a lack of good faith on the part of the mortgagee, which was liable for the conduct of its solicitor.

I. *AN APPARENT CONFLICT OF INTEREST*

A further concern was the fact that the solicitor for the mortgagee had previously acted for Friedman. This became important in so far as Bali Hi was sold to Friedman in a sudden manner, without allowing it to go to auction, and in apparent disregard of the interest which had been shown by the other prospective purchasers.

This led Murphy J. to question the motives of the mortgagee's solicitor, and to conclude that he was 'either consciously or unconsciously overborne by the fact that Friedman was not only a client of his but also an acquaintance and a man of substance recognized in the community in which he moved as possessing fine acumen in searching out profitable land development projects.'[55]

[54] *Ibid.* 278.

[55] *Ibid.* 274. See also 263 where Murphy J. referred to the judgment of Jacobs J. in *A.N.Z. Banking Group Ltd v. Bangadilly Pastoral Co. Pty Ltd* (1978) 139 C.L.R. 195. In that case Jacobs J. thought the closer the association between the mortgagee and his associate, the greater was the possibility of unconscious preferment.

J. *THE OUTCOME*

The formal order pronounced was that the contract of sale to Romalla Pty Ltd be set aside, and that Romalla remove the caveat lodged. It was further declared that the contract of sale of the Lilydale land was unenforceable and void against the plaintiff. It was ordered that the first named defendant be enjoined against completing that contract. The third named defendant was directed to remove the caveat lodged. The defendants were ordered to pay the plaintiff's costs.

K. *WHAT PRECAUTIONS SHOULD A MORTGAGEE TAKE?*

As indicated earlier, the *Goldcel* case illustrates a number of matters which must be borne in mind by mortgagees and their advisors. It is opportune to examine some of these in more detail, and to also refer to others not specifically dealt with in Murphy J.'s judgment.[56]

1. *Independent purchaser — avoiding conflict of interest*

It is clear law that a mortgagee cannot sell to himself. However, the courts have not necessarily set aside a sale to a corporation in which the mortgagee is a director and shareholder, as this would infringe the principle that a company is a separate entity from its members.[57] Nor will a sale to an employee invariably involve a conflict, provided *bona fide* attempts have been taken to sell the property.[58]

However, as the *Tse Kwong Lam* case shows, if there is a close relationship between a mortgagee and a purchasing company, a sale will be carefully scrutinized. As Washburn [59] says, when referring to the United States position where some jurisdictions do allow a mortgagee to purchase the property himself, courts rely on purchase by a stranger to indicate the regularity of the sale and the fairness of the purchase price.

The judgment of Murphy J. reflects a misgiving about the relationship between the mortgagee's solicitor and Friedman. The sale to a client, present or past, by a solicitor acting on behalf of a mortgagee would appear to be unwise. The safer course would be to allow the property to go to auction, especially if there are other prospective purchasers.

One would also venture to suggest that the better approach may well be for the solicitor to withdraw from negotiations altogether, and to leave it to the mortgagee to negotiate directly. Certainly the danger of continuing to act is that the solicitor may be drawn into litigation, and become the focus of judicial scrutiny and criticism.

[56] For an excellent analysis of the various precautions which a mortgagee should have regard to, see Vann, *op. cit.* which, although dealing with the Queensland Property Law Act, is still of enormous value.

[57] *Farrar v. Farrars Ltd* (1888) 40 Ch.D. 395.

[58] *Sewell v. The Agricultural Bank of Western Australia* (1930) 44 C.L.R. 104.

[59] Washburn, R. M., 'The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales' (1980) 53 *Southern California Law Review* 843.

2. *Sale before auction*

Section 77 contemplates that a mortgagee may sell either at auction or at private sale. In the *Tse Kwong Lam* case the Privy Council emphasized that sale by auction is not necessarily the most effective way of realizing the mortgaged property. Similarly, in *Bank of Cyprus v. Gill*,[60] the Court of Appeal stated that sale by private treaty may be preferable if the market is depressed.

However, as the Editor of Fisher and Lightwood's *Law of Mortgages* points out,[61] to accept a lower price at private sale than a prospective purchaser with means has indicated he would bid at auction, may be a breach of a mortgagee's duty. A mortgagee must act carefully and give due consideration to any offers made.

In the *Goldcel* case the interest shown by the two prospective purchasers of Bali Hi, and by Pignataro, was not sufficiently exploited, and the mortgagee had not properly considered whether it would be preferable to proceed at auction.

It is obvious that the mortgagee's task is a difficult one. In deciding the best method of realizing his security, the mortgagee must not only have regard to his own interests but, in the language of s. 77, to the interests of the mortgagor.

3. *Price*

The courts have consistently held that the fact that the property is sold at an undervalue will not, of itself, constitute a breach of duty, unless the price obtained is so low as to be evidence of fraud.[62]

But as *Colson v. Williams*[63] emphasizes, a mortgagee is not entitled to sell for a sum sufficient to see him paid out, but if there is a margin which can reasonably be obtained, then the interests of the mortgagor or second mortgagee must be taken into account.

It will be recalled that Murphy J. in the *Goldcel* case, stated that part of a mortgagee's duty includes the obligation to take reasonable steps to get on sale the *best* price for the mortgagor's property. This can be contrasted with the formulation of Gibbs C.J. in *C.A.G.A. v. Nixon*, that the duty, under s. 85 of the Queensland Property Law Act, is to take reasonable care to ensure that the property is sold at *market value*.[64]

It may well be that there is little significance as to which is the proper test to be applied, especially as the evidence of valuers can be quite contradictory and inconclusive. Nevertheless, a mortgagee should appreciate the dangers involved in not paying proper regard to a mortgagor's interests in selling the mortgaged property, especially if there are, as in the *Goldcel* case, purchasers who may be willing to pay more than the sum obtained on sale.

60 [1980] 2 Ll. Rep. 51; reviewed in (1982) 56 *Australian Law Journal* 39.
61 (1977), 368.
62 In this context see Butt, *op. cit.* 181.
63 (1889) 58 L.T. 539. See also the judgment of Lush J. in the *Henry Roach* case, *supra*.
64 (1981) 56 A.L.J.R. 130, 132. Compare this with Salmon L. J. in *Cuckmere*'s case who refers to 'true market value'. Menzies J. in *Forsyth v. Blundell* talks of 'proper price', whilst Jacobs J. in the *A.N.Z. v. Bangadilly* case mentions the 'best price obtainable'.

4. *Disclosure of reserve*

In *Barns v. Queensland National Bank Ltd*,[65] Griffith C.J. criticized the conduct of the mortgagee in disclosing the reserve which had been placed on the property. Similarly, in the *Tse Kwong Lam* case and *ANZ v. Bangadilly* case, the Privy Council and High Court were concerned that the sale of property to an associate of the mortgagee inevitably led to disclosure of the reserve.

In the *Goldcel* case, the indication by the estate agent, Hall, to Pignataro that $140,000 would be sufficient by buy the Lilydale property was also criticized by Murphy J. Estate agents, and others acting on behalf of mortgagees, should be wary of revealing information which would not normally be disclosed to purchasers.

5. *Setting of a reserve and obtaining a valuation*

Whilst referring to reserves it should be emphasized that a mortgagee would be wise to take the precaution of setting a reserve. He should also be careful to ensure that the reserve fixed is a realistic one, as the setting of a low reserve can be evidence of fraud.[66]

In this context it would be prudent to obtain a valuation of the property.[67] As Vann[68] points out, it is desirable that the valuation should be obtained from an agent not involved in the sale of the property. It is also important that the valuation should not be out of date.

6. *Consulting with the mortgagor*

In the *Goldcel* case, Murphy J. stated that as a matter of law it is not necessary for a mortgagee to consult with the mortgagor. But his Honour went on to say that, as a matter of prudence, having regard to the wording of s. 77, consultation might well be a wise course to take.[69]

Certainly solicitors should ensure that any undertakings to consult or inform the mortgagor's solicitor regarding a proposed sale are honoured. In addition, as *Cuckmere's* case illustrates, in some circumstances it may be desirable to postpone selling the property, if requested by the mortgagor, because of insufficiency of advertising.

The problem that the mortgagee faces is to assess whether a request for a postponement is a legitimate one, or merely a device to 'stall' the sale of the property. Such judgments may be difficult, but in reaching any decision a solicitor acting for a mortgagee should balance the request to hold the sale at a later date as against the risk of subsequent litigation.

65 (1906) 3 C.L.R. 925.

66 *Dimmick v. Pearce Investments, supra, per* Kelly J.

67 Francis, *op. cit.* 99 says that although *Pendlebury's* case may not require a proper and detailed valuation in every case, prudence indicates that a mortgagee should at least obtain an opinion from a competent agent.

68 *Op. cit.* 142-3.

69 *Supra* 272.

7. *Advertising*

A further matter which arose in the *Goldcel* case was the complaint by the mortgagor that the properties had not been advertised in the Saturday papers. In the light of the sales prior to auction this did not prove to be an issue in the case. However, Murphy J. indicated that it may have proved to be a material issue had the auction proceeded.[70]

Mortgagees should be fully aware of the implications of *Pendlebury's* case,[71] and the need for proper and detailed advertising. A mortgagee should be prepared to scrutinize the advertising of the property to ensure that it is adequate in its frequency, and that it is placed in appropriate newspapers.[72] As *C.A.G.A. v. Nixon* makes clear, it is not a sufficient discharge of a mortgagee's duty in this respect simply to instruct agents to sell the property on his behalf.[73]

In advertising, care should be taken to ensure that any attributes of the property are correctly described, that its location is not the subject of conjecture (as in *C.A.G.A. v. Nixon)*, and that advertisements are placed sufficiently in advance of the date of sale.

Cuckmere's case illustrates the importance of referring to planning permission. In the *Goldcel* case no reference had been made to the fact that in relation to the Bali Hi property permission for sub-division had been obtained. In view of the findings on other matters, however, it was not necessary to consider this matter in detail.[74]

8. *Employment of agents*

It is not a defence to a mortgagor's suit that the mortgagee employed competent agents. A mortgagee should ensure that he is intimately aware of the acts of his agents, and take care to supervise them where necessary. It will be recalled that in the *Goldcel* case the mortgagee was held responsible for the conduct of its solicitor and estate agent.

9. *Timing of sale*

This was not a matter which needed to be specifically considered in the *Goldcel* case, but because of recent decisions it is appropriate to consider it. In *Henry Roach*, Lush J. stated that s. 77 does not detract from the common law rule that a mortgagee may sell at the time which best suits him. A similar view was expressed by the Privy Council in the *Tse Kwong Lam* case, when discussing the position in England.[75]

In the *Goldcel* case Murphy J. referred to the fact that there were difficulties in the concept that a mortgagee may choose when and how to sell, but at the same time have regard, in selling, to the interests of the mortgagor.

[70] *Ibid.* 277.
[71] *Supra.*
[72] The *Henry Roach* case, *supra*, suggests that in some circumstances advertising overseas may need to be considered.
[73] *Supra.*
[74] *Supra* 278.
[75] See also *Bank of Cyprus v. Gill*, *supra.*

Kelly J. in *Dimmick v. Pearce Investments* suggested that a mortgagee might display a lack of good faith in not postponing a sale if the market was improving rapidly and substantially.[76] His Honour, however, stressed the need for clear signs that the market was improving.

Moreover, in *Standard Chartered Bank v. Walker*[77], Lord Denning M.R., when referring to a sale by a receiver, said that it may be that a receiver could choose the time of sale within a considerable margin, but that he was obliged to exercise reasonable care about it.

These views have been criticized,[78] although it may be argued that in *Walker's* case the receiver was held liable in selling at the worst possible time. Nevertheless, *Walker's* case does appear to place an onerous responsibility on mortgagees, and extend their duty further than may be necessary.

10. *Duty to guarantors and to other persons*

Another aspect of *Walker's* case that has been the cause of comment was the finding that a receiver owes a duty to guarantors.[79]

Section 77 of the Transfer of Land Act provides, *inter alia*, that in selling the property the mortgagee shall have regard to the interests of the mortgagor, grantor or other person. As Hobson[80] points out, it is possible that the requirement to have regard to other persons may require a mortgagee to exercise care to protect the interests of a guarantor.

In a recent publication[81] it was also stressed that, in the light of recent case law, it would be prudent for a mortgagee not to overlook the position of a guarantor when exercising a power of sale.

L. *CONCLUSION*

This article has mentioned a number of matters which a mortgagee and his advisors should have regard to when realizing mortgaged property. The writer has omitted reference to others, such as whether a mortgagee is obliged to expend money on the property to enhance its resale value,[82] or conditions which can be included in the contract of sale.

One of the most important however, in the writer's view, is the need for an appreciation that a mortgagee must do more than simply take steps to recover his debt. As Robertson says:

76 *Supra* 243.

77 [1982] W.L.R. 1410, 1416.

78 [1983] All E.R. *Annual Review*. Butt, P., 'More on Sale by Mortgagees' (1983) 57 *Australian Law Journal* 238, 242 says 'Lord Denning's *dictum*, it is respectfully suggested, introduces a qualification upon the exercise of the power of sale which is supported neither by principle nor authority.'

79 See Butt, (1983) *op. cit.* 242-4, and Wilkinson, 'The Mortgagee's Duty To Mortgagors and Guarantors' (1982) *New Law Journal* 883. *Walker*'s case has been recently affirmed in *American Express International Banking Corporation v. Hurley [1983] 3 All E.R. 564.*

80 (1979) 53 *Australian Law Journal* 102.

81 Business Law Education Centre, *Recent Developments in Securities Law* (1985) 88.

82 See the Irish case of *Holohan v. Friends Provident and Century Life Office* [1966] I.R. 1.

> In normal sales the vendor actually has the discretion to prevent a sale at what he considers to be an undervalue. The difference can be minimized if secured creditors were to adopt the stance that notwithstanding the fact that the sale is a forced one, the property will not be sacrificed so as to benefit bargain hunters. The more a forced sale resembles a sale of 'fair market value' the higher the probability that the best price will be obtained. A 'fair market value' is, in truth, only an estimate made on the assumption that reasonable precautions will be taken to expose the property to the greatest number of individuals in any one market.[83]

The *Goldcel* case highlights many of the pitfalls which a mortgagee faces in realizing his security. As indicated previously, it also emphasizes the need for a solicitor acting for a mortgagee to take into account the interests of the mortgagor. For those practising in this area the judgment of Murphy J. is one which should be carefully studied.

[83] *Op. cit.* 117.