ABIO Special Bulletin:

Mortgagee Sales

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Mortgagee Sales: Current issues

In this issue, we discuss in some detail aspects of mortgagee sales and ABIO's approach to the issues raised.

The Bulletin:

- Summarises the duties owed by mortgagees;
- Discusses aspects of mortgagee sales including advertising, ascertaining market value and the manner and management of sales; and
- Sets out the questions we consider when investigating a dispute about a mortgagee sale.

Introduction

The experience at ABIO is that disputes regarding mortgagee sales are difficult. They are difficult because an assessment is required about whether the price obtained was appropriate, sometimes without the benefit of reliable valuation material and when we, like other decision makers, are not experts on valuations. They are difficult because each case will depend on the circumstances before, during and after the sale. It is often the case that, even where we it appears that there has been a bank error, loss is unable to be identified or is difficult to ascertain.

These cases are also difficult because what is required is a balancing of interests and entitlements. The mortgagee has a legal entitlement to receive repayment of the debt and to sell the security property to recover that debt if necessary. The mortgagee is entitled to decide when and how to sell and owes no fiduciary duty to the mortgagor when doing so. On the other hand the courts and legislation seek to protect the mortgagor's interest in the property not being sacrificed and for the property to be sold at the best possible price.

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BULLETIN

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Introduction (cont)

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For every court decision which expresses a view on an issue, there may well be another which says something different. Why? Because the cases are decided on the facts and taking into account all of the evidence. While there are useful statements of what the duty of mortgagee is, it is always necessary to apply those statements to what happened and it is this process which is most challenging.

ABIO appreciates that the weighing up of information and the decision making process undertaken by a mortgagee about a sale is also challenging and so it is not surprising that there are differences of opinions about the sale process in any one case coming from the mortgagor, the mortgagee and ABIO. In these cases, ABIO encourages the parties to seek out a satisfactory resolution wherever possible and, where that cannot be achieved, ABIO will reach a view taking into account the law, good industry practice, any applicable industry code and fairness.

The law

The law applicable to the sale of property by a mortgagee depends on the state or territory in which the property is located. Reference will be made to the state or territory wherever it has a bearing on the discussion.

The common law governs the Australian Capital Territory, New South Wales, the Northern Territory, South Australia and Western Australia. For Queensland, Tasmania and Victoria reference must be had to the relevant statute.

Section 420A of the *Corporations Act 2001* (Cth) sets out the duties arising on the sale of corporate property by a mortgagee in possession or where a mortgagee has appointed a receiver under the Act.

Common law – ACT, NSW, NT, SA & WA

There has been and remains some conflict as to the manner in which the mortgagee's duty ought to described. The English approach has been to require a mortgagee not to act negligently and to take reasonable care to obtain the true market value of the property.[1]

While the High Court has yet to make a final determination on the issue, the Australian courts generally state the duty as being to act in good faith and without a reckless or wilful sacrificing of the interests of the mortgagor.[2]

What does it mean to act in good faith? The courts have said that to act in good faith is to act honestly and not fraudulently.[3] Another way to put it is to say that the mortgagee's duty is to not cheat the mortgagor.[4] There would be a clear failure to act in good faith if there was deception, corruption, collusion or actual fraud in the sale process.

Even if these examples of bad faith were not present, by acting wilfully and recklessly in a manner which is not in the interests of the mortgagor, a mortgagee may act in bad faith.

Where a mortgagee exercises the power of sale in good faith, without any intention of dealing unfairly by the mortgagor, it is highly unlikely that a breach of the duty would be established. However, if the mortgagee wilfully and recklessly deals with the property in such a manner that the interests of the mortgagor are sacrificed, then it would be difficult to say that the power of sale had been exercised in good faith.[5]

The common law duty is owed to the mortgagor and it has been held to be owed to a guarantor and to a second or subsequent mortgagee.[6]

Whether or not the mortgagee complies with the common law duty is a question of fact which for ABIO will require a careful review of the bank file and any other relevant files (for example files held by the selling agent or an agent appointed to manage the sale for the bank). In some cases it may be necessary to seek additional valuations or material relating to the sale practice, including the files of any external consultant or agent and the bank's real estate agent.

Given the limits on the Ombudsman's capacity to take evidence on oath when investigating cases it is unlikely that we would reach a finding of bad faith in terms of fraud, deception or collusion but we may conclude that a bank acted wilfully or recklessly in a manner which was not in the interests of the mortgagor.

The statutory duties – Qld, Tas & Vic

Queensland

A mortgagee exercising a power of sale in Queensland is obliged by section 85 of the *Property Law Act 1974-1986* (Qld) "*to take reasonable care to ensure that the property is sold at the market value*".

Section 85 says relevantly:

> "*(1) It is the duty of a mortgagee, in the exercise after the commencement of this Act of a power of sale conferred by the instrument of mortgage or by this or any other Act,* ***to take reasonable care to ensure that the property is sold at the market value.***" (emphasis added)

In addition, a mortgagee is obliged to comply with the common law duty to act in good faith as discussed above. The duty in Queensland is seen as the most strict in Australia and so the steps taken by a mortgagee in that state must be reviewed in a slightly different way and by applying a higher standard.

Whether or not the mortgagee complies with the section 85 duty is a question of fact.

The case law indicates that the duty is not satisfied by simply listing the property with a competent agent and leaving it to the agent to attend to the advertising and arrangements for the sale of the property.[7] The same would apply where the mortgagee appoints a consultant to manage the sale of the property (including the appointment of the agent) – the mortgagee would still be obliged itself to ensure that reasonable steps had been taken to sell the property at market value and if they have not been taken then the mortgagee would be liable to the mortgagor.

The duties owed under section 85 are owed not only to the mortgagee but also to any party who may be "*damnified by*" a breach by the mortgagor, for example a guarantor.[8]

Tasmania & Victoria

As the statutory duties are worded in a similar manner, the two states have been dealt with together.

Section 77 of the *Transfer of Land Act 1958* (Vic) says that a mortgagee:

"*. . . may,* ***in good faith and having regard to the interest of the mortgagor . . . or other persons,*** *sell . . .*" (emphasis added)

Section 77 is seen as requiring a mortgagee to meet the common law standard of good faith described above but also to take account of the interests of the mortgagor. Whether or not the mortgagee had "*regard to the interest of the mortgagor*" is assessed as an objective test and introduces what is seen as a higher standard than the common law duty.

Guarantors would be regarded as "*other persons*" under section 77 and so a mortgagee would also have to have regard to the interests of a guarantor when selling.

The case law requires the mortgagee to obtain the best price available at the time of sale.[9] Accordingly, it is not a question of the mortgagee obtaining the best price that could ever be obtained but the best price at the time the property is offered for sale taking into account the mortgagee's entitlement to sell at a time of its own choosing. The other factors relating to the manner of sale discussed below (for example sale by auction or private treaty, advertising and the value of the property) will also be relevant to the question of the best available price at that time.

For the purposes of this discussion, references to the best available price will be treated as being equivalent to the market value of the property.

Section 78 of the *Land Titles Act 1980* (Tas) says:

"*. . . the mortgagee . . . may, in good faith and having regard to the interests of the mortgagor . . . and other persons . . . sell*"

The same considerations as discussed above in relation to Victoria are to be applied to the sale of property in Tasmania including an expectation that a guarantor would be within the meaning of "*other persons*".

Corporations Act

The Corporations Act will be relevant where the mortgagor is a corporation and where the bank has taken possession of corporate property or appointed a receiver who has taken possession of corporate property. When selling that property the bank or its receiver is required to comply with the statutory duty contained in section 420A.

Section 420A (1) of the *Corporations Act 2001* (Cth) ("Corporations Act") says:

"*In exercising a power of sale in respect of property of a corporation, a controller must take all reasonable care to sell the property for:*

(a) *if, when it is sold, it has a market value – not less than that market value; or*
(b) *otherwise – the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.*"

A "*controller*" includes a bank as mortgagee in possession or a receiver appointed by a bank.

In most cases ABIO expects that a market value would be ascertainable and so sub-section (a) would apply.

In broad terms, the duty under section 420A is most similar to that owed by a mortgagee selling in Queensland. Accordingly, a number of the comments made above about such sales can be applied here including those regarding the appointment of agents and advertising.

The duty as described requires the mortgagee or receiver to ascertain what the market value of the property is at the time of sale.

A property may be sold by auction, private treaty or by tender. Many mortgagees sell corporate property by auction as it is considered the method most likely to ensure that the market value is established and obtained. It is possible for a private sale to be completed within the terms of the duty although this may be a risky course of action in some cases.[10]

As the focus of section 420A is on obtaining market value, ABIO will look carefully at all of the surrounding circumstances to ensure that the mortgagee did in fact test the market.

We would look for information showing that there was adequate advertising, responses to genuine enquiries about the property and, preferably, sale by auction. If a mortgagee was aware of several interested parties but simply sold quickly to another because the offer was within the valuation, there may have been a breach.[11] A receiver who failed to advertise or call for tenders was held to have been negligent.[12]

Market value

The concept of market value is crucial to the assessment of claims in Queensland and under the Corporations Act. As discussed earlier, in Victoria and Tasmania regard is to be had to whether the mortgagee obtained the "*best price possible*" but this term can be read as being equivalent to market value.

The starting point for describing market value comes from the decision of Griffith CJ in *Spencer v The Commonwealth* as follows:

"*In my judgement the test of value of land is to be determined, not by enquiring what price a man desiring to sell could actually have obtained for it on a given day, i.e., whether there was in fact on that day a willing buyer, but by enquiring* '***What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?***"[13] (emphasis added)

While it is not by any means usual for a vendor to be "*not desirous to sell*", we understand that what is meant is that there are no surrounding circumstances or pressures which could result in the acceptance of anything less than a fair price.

In Queensland it has been said that it is not necessary to show that an actual purchaser would have paid more but it is necessary to show that the price obtained was less than market value as determined by having regard to expert and other relevant evidence.[14] In our view this approach can be applied to claims under the common law and that other statutory provisions.

The Australian Property Institute has issued a guidance note dealing with the mortgage industry and has adopted the International Assets Valuation Standards Committee definition of market value which it sees as paraphrasing the definition in *Spencer*.[15] Market value is defined as:

" *. . . the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms' length transaction after proper marketing wherein the parties had each acted knowledgably, prudently, and without compulsion.*"

The term market value does not include the concept of a forced sale value and so a figure based on a forced sale would not be regarded as the correct measure.[16] While

it may be correct to say that the mortgagee was forced in a practical sense to sell the property, that does not mean it is only entitled to obtain the forced sale value which may be included in a valuation.

Essentially the reason why a forced sale value is not an appropriate measure of the value of a property is because the law requires that the mortgagee obtain market value and not a forced sale value. In our view a mortgagee ought not to have regard to a forced sale value when determining a reserve or listing price or when assessing an offer. For the same reasons ABIO will not have regard to forced sale values when assessing cases.

In some cases it may be necessary for ABIO to engage a valuer to give an expert retrospective opinion on the market value of a property. For example, if advertising is so inadequate that we cannot be satisfied that the property was put to the market and the valuation material available is not clear or adequate, an independent and retrospective valuation may be required.

Sale practice and possible breaches

Following is a discussion (in alphabetical order) of a number of sale practices and the issues which arise from them. In each discussion we have tried to identify the facts which might raise a possible breach or cause for concern. It is always necessary to consider the nature of the issue and then assess the facts in the particular dispute.

Advertising

It is often the case that disputants complain about the advertising which was carried out and believe that it was inadequate. The cases indicate that whether or not there was sufficient advertising will depend on the circumstances of the sale, the property and the usual practice for the locality and type of property.

Obligation to advertise

It is well settled law that a mortgagee in possession is obliged to advertise the property.[17] What is not settled is precisely how that is to be done and to what extent.

At times ABIO may be at a disadvantage when assessing issues around advertising because we are not always familiar with different localities and advertising practices. Having said that, we can obtain information about what can be expected from:

- Any marketing proposals obtained by the bank before appointment of an agent – usually held on the bank's file;
- The actual advertising done;
- Comments contained in valuations and/or market appraisals about how to advertise, to whom and for how long;
- Bank policies and procedures; and
- State based real estate organisations such as the REIV.

We would include the following as being part of an advertising campaign:

- Print advertisements – newspapers, specialised real estate magazines, agent's brochures;
- Internet advertisements;
- Real estate agent's window advertisements;
- Boards;
- Handbills or flyers;
- Contact by the agent with potential purchasers known to him/her; and
- Holding open for inspections – whether open to the public or by arrangement.

Adequacy of advertising

When looking at the adequacy of advertising it might be useful to start with the understanding that the mortgagee would not be expected to conduct the most lavish or widespread campaign possible. The mere fact that certain advertising could have been done does not mean it was necessary to meet the duty.

We would regard the case of *Pendlebury v Colonial Mutual life Assurance Society Ltd* which was decided by the High Court in 1912 under the common law duty, as the starting point for any assessment of the adequacy of advertising.

The facts in Pendlebury were that the auction commenced and, part way through the bidding, the auctioneer asked the mortgagee's representative what the reserve price was. In response the mortgagee's representative gave the auctioneer a piece of paper which showed the total of the debt, the auctioneer's commission and other charges. The court considered that this indicated that the mortgagee's representative had no thought about the possibility of a surplus and seemed only concerned with obtaining a price sufficient to pay the debt plus the appropriate commission. The facts indicated that the successful bidder must have known the amount of the reserve.

The important factual points to note concerning advertising in this case were:

- Advertisements for the auction of the property were placed in Melbourne newspapers only even though it was a rural property;
- The identification of the property was insufficient for anyone unfamiliar with the land to know where it was within the local area;
- The advertisements did not sufficiently describe the features of the property so as to draw attention to its appeal; and
- No board was erected and nor were brochures were distributed in the area and so not even the owners of the neighbouring property knew it was for sale.

The court found that the advertising was entirely inadequate in the circumstances.

In terms of the advertising, the court considered that it was so inadequate that the mortgagee could be said to have "*. . . absolutely disregarded the interests of the mortgagor.*"[18] Taken together with the conduct of the auction, the court considered that the mortgagee was in breach of its duty.

A useful test of whether the advertising was sufficient comes from the High Court's decision in *Commercial & General Acceptance* which concerned the mortgagee's duty selling in Queensland. Gibbs CJ said:

"*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.*" [19] (emphasis added)

Mason J referred to the manner in which a reasonable and prudent vendor would advertise.[20]

While the case clearly concerned a sale by auction the comments as to adequacy can be equally applied to sale by private treaty and to the duty owed at common law and in the other states.

The judge who first heard the case found that the placement of one advertisement

in a local metropolitan newspaper only a few days before the sale on a day that these advertisements were not usually placed was insufficient.[21]

We see advertising as an essential step in the process of generating interest and competition so that the market price can be obtained. If the "market" is not alerted to the sale of the property it may be difficult to conclude that the market price has been obtained. However, a failure to advertise in what may be regarded as an adequate manner will not always mean that there has been a breach – provided of course that we are satisfied that the price obtained reflected the correct market value.[22] Ascertaining the value of the property will be a crucial part of this assessment.

The mortgagee should be careful as to the description of the property in advertisements. The description of the property should accurately describe its location and cover all relevant planning permissions and possible redevelopment opportunities which are known to the mortgagee.[23]

Advertising as mortgagee sale

At times a mortgagee will advertise a property as being sold by a mortgagee. Whether or not banks advertise in this way seems to vary from bank to bank and from state to state. We are not aware of any case law on whether this is an appropriate form of advertising.
While on the one hand any prospective purchaser can readily become aware of who is selling by reviewing the contract of sale or even asking the agent, advertisements containing a reference to the mortgagee may suggest that it will be sold for a cheap price or that it is in effect a forced sale. This comment particularly applies to a private sale. However, it has been suggested that the use of mortgagee sale in advertising for an auction may be a positive as it may attract more potential purchasers.

At this stage, if a property is advertised as a mortgagee sale, ABIO would ask questions of the bank about its usual practice and why this form of advertising was used. There may be an overlap with issues concerning the setting of the reserve if the price obtained was very close to the amount of the debt. It may also be necessary to ask whether other mortgagees would have regarded it as reasonable to advertise in this manner. Advertising in this way may be seen as a signal to the market that it is a forced sale.

Ascertaining the value of the property

The courts have held that a mortgagee is bound to take reasonable means to ascertain the value before selling.[24] The usual procedure of most banks acting as mortgagee is to obtain a sworn valuation. Sometimes a mortgagee may rely on an estimate of value from an experienced real estate agent.

As the obtaining of a sworn valuation is standard industry practice, we expect that a bank would obtain at least one sworn valuation in the absence of a reasonable explanation as to why that was not done.

The information we have as to usual bank procedures is that at least one marketing proposal is usually obtained which includes matters such as a suggested market value, recommendations for the conduct of the sale of the property, a marketing program, recommendations for advertising, details of any work required to prepare the property for sale and any potential problems with the sale or marketing of the property. While this is not legal requirement, we would expect a similar proposal to be obtained and, if one was not, an explanation as to why not.

Auction vs private sale

It could not be said that it is always necessary to sell by auction in order to comply with either a common law or statutory duty. However, we consider it to be incumbent on a mortgagee to show that there were reasons for deciding to sell by private treaty rather than by auction. This is because an appropriately advertised auction will usually be the best way to ascertain and obtain the market value of the property.

Following are references to cases which have considered the issue of manner of sale and they can be taken as general guidance notes:

- In the Queensland case of *Martin v Lewis* the mortgagee sold a boat by private treaty and the duty under section 85 arose. Andrews ACJ said (at 11):

  "Certainly, the obligation is to take reasonable care to ensure the full market value is obtained at the time when the property is sold. ***If it is not sold at auction but by private treaty, then it seems to me that the mortgagee is under a duty not to rush the sale unduly, bearing in mind that he is not required to pick the most advantageous instant of time from the point of view of the mortgagor****."* (emphasis added);

- In *Pendlebury* Griffith CJ discussed the object of sale by auction. He said:
  "*In my opinion,* ***the object of 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.****"*[25] (emphasis added); and

- In the case of *Larkin v Flew*[26] (concerning section 420A of the Corporations Act) the court expressed the view that, where there is uncertainty as to the value of the property, a sale by auction is the most effective way to determine its market value. The court also considered that, where a private sale was thought preferable, it was essential that a valuation be obtained and that the asking price be set in accordance with the valuation. I note that sale by tender is sometimes used for corporate property and can generally be regarded as analogous to sale by auction.

It is ABIO's view that a decision to sell by private treaty on the recommendation of an agent and/or valuer would be one which is open to a mortgagee to make assuming that the reasons for making that decision are evident and are supported by any appraisal or valuation.

However, having made that decision, the manner of marketing and advertising becomes very significant: the mortgagee's duty is to ensure that it acted to bring the attention of potential purchasers to the property so that it could generate competition and so obtain market value.

Improvements before sale

There is no general obligation on the mortgagee to make improvements to the property before sale. This is the case, even if a prudent owner might risk a substantial outlay in order to secure a possibly higher price.[27]

However, it has been said that, if some expenditure was reasonable in the circumstances and apparently necessary and prudent to conserve the mortgagor's

interest and to prevent his interests being sacrificed and if the amount to be spent would be consistent with the total selling value, then the mortgagee would be expected to spend the funds.[28]

This approach needs to be treated with caution – it would be unusual for ABIO to conclude that a failure to spend funds on a property would amount to a breach of duty.

Having said that, there are some forms of spending which we may regard as usual: for example usual repairs to and maintenance of the building, cleaning and garden maintenance, repairs to pool equipment. If a property could not be legally sold without a pool fence, then it may well be appropriate for the mortgagee to expend funds to have one constructed. In one case we have seen a bank decide that it was appropriate to spend a modest amount on removing a termite infestation. In another the bank decided to have the house re-painted – an expense which may have been excessive.

Independent bargain

A mortgagee may not sell to itself alone or with others or to a trustee for itself – a mortgagee is expected to make an independent bargain. However, the fact that the mortgagee is a shareholder of the purchaser would not mean that the sale was invalid.[29]

There is no general prohibition on a mortgagee selling to an employee provided that the sale was made in good faith and not for undervalue.[30] If there is a close relationship between the mortgagee and the purchaser then the mortgagee must prove that the sale did not involve a breach of the duty. An example would be if the bank officer who recommended that a property be sold and who had a say in the reserve bought the property or an associate did.[31]

Insurance and protection of the property

A mortgagee would usually have the power under the terms of the mortgage to insure the property and charge any premiums to the mortgagor. The mortgage would also usually make provision for other expenses to be incurred to protect the property from vandalism or other damage. Given the usual procedures adopted by banks we would expect that insurance would be obtained as a matter of good industry practice, subject of course to the costs involved. This would particularly be the case if the mortgagee became aware that existing insurance has lapsed.

Management of the sale

It has been held in both Queensland and under section 420A that a mortgagee does not fulfil its duty by appointing a competent agent and leaving the sale process and all relevant decisions to that agent. Similar views have been expressed in relation to claims under the common law and in Victoria.[32]

It is becoming increasingly common for banks to outsource a large amount of the management of the sale process. It appears that banks usually set the reserve and give instructions about the manner of sale and advertising however it can sometimes be the case that the agent or consultant makes these decisions.

In the event that the agent or consultant fails to meet the standard applicable to the bank as mortgagee, the mortgagee will be treated by us as liable. In order to assess the sale process it will be necessary to obtain the files of any agents or consultants involved. This is essential in cases where the bank has effectively handed over control.

In these cases, it may be that the failure to supervise to any reasonable degree would be a breach in Queensland or in the case of corporate property. As stated earlier, the duty to take reasonable care applies to each step in the sale process and so any failure to take that care by an agent may contribute to the mortgagee not obtaining market value.

Sale expenses

It is likely that the terms of a mortgage would make sufficient provision for all expenses relating to the sale to be charged to the mortgagor. These clauses tend to be widely drafted and would cover agent's fees, valuer's fees, solicitor's fees and costs associated with maintenance. Some of the provisions include a reference to the fees being reasonable.

In ABIO's Bulletin Number 34 it was said that, if a multiplicity of agents has resulted in apparently excessive costs being charged to the mortgagor, then this office will consider the extent to which those costs may be passed on.

There may also be scope to consider whether other costs ought to be passed on. In particular:

- Payment of commissions or for advertising which exceeded that originally quoted by the real estate agent or out of step with standard rates;
- Payment for repairs and improvements made **after** the property had been sold and where no reference was made to those repairs and improvements in the sale contract; and/or
- Payment for repairs and improvements which are not apparently necessary and are beyond what a prudent mortgagee would be expected to effect.[33]

In all cases the terms of the mortgage would be required to be checked before a decision was made requiring a refund to be made.

Duty to account

It is clear law that a mortgagee in possession owes a duty to account to the mortgagor.[34] Despite this we often receive complaints that a mortgagee has not notified the mortgagor that a property has been sold. It is not uncommon for the mortgagor to receive none or little information about the costs associated with the sale for which the mortgagor has been charged. ABIO regards the provision of this information promptly and in sufficient detail for the mortgagor to identify and understand all costs to be consistent with the law and good industry practice.

Sale price and the amount of the debt

If a mortgagee sets out to recover the amount of the debt owed and has no regard to whether a higher amount could be obtained for the property, it would be a breach of the common law or statutory duty. This proposition was contained in the decision of the High Court in Pendlebury and has been referred to with approval and applied since by numerous other courts.[35]

Setting the reserve and disclosure of the reserve

The duty owed by a mortgagee (whether at common law or under statute) extends to each step including setting the reserve. As noted earlier, in the context of the Queensland statute, a mortgagee was found to be in breach of the duty when the reserve was set based on a valuation plus a margin when the representative of the mortgagee had notice of specific information indicating a higher market value.[36]

In the case of Cameron the duty in relation to the setting of a reserve was discussed. The court said that:

- A mortgagee exercising its power of sale by way of auction must exercise reasonable care in fixing the reserve;
- Its duty goes beyond simply commissioning a report from an expert valuer and fixing as the reserve the figure in the bottom line of the report; and
- It is obliged to consider the whole report, to seek clarification as necessary and not to adopt the valuation in the absence of a reasoned case in support of it.[37]

In the case of *Goldcel Nominees* the court considered that the valuations may well have reflected the correct value of the properties but that at auction the price would have exceeded those figures. As a result, the asking price which was made apparent to the potential purchaser was considered too low.

In both of these cases there was information available to the mortgagee which was relevant to the appropriate asking price and which indicated that the valuations/advice it had obtained were too low.

In all cases ABIO can have regard to the contents of any valuations available to the mortgagee and also any other information available at the time the reserve was set to satisfy ourselves that the reserve was appropriate. In some cases a low reserve will not necessarily mean that too low a price has been obtained – the level of interest and number of bidders at an auction may push the price well beyond the reserve figure.

The approach may be different if there is a limited market (as there was in *Cameron*) or if an asking price is set for a private sale and it has been disclosed specifically or as part of a range. If the reserve is objectively too low then it may result in effectively ensuring that the true market value is not obtained.

In cases where there is a private sale we will check what reserve was set and whether that amount was disclosed or indicated to potential purchasers by the agent or any other party acting for the mortgagee.

It is not uncommon to see properties advertised with a specific figure included. If a price is included in advertising by a mortgagee in possession, we would want to be satisfied that the price was soundly based on valuation and other information available. We would also want to check that the price was not either too low or too high. If it is too low then its disclosure effectively ensures that no price higher will be obtained. If it is too high then the property may be overlooked by buyers who would be interested in paying a more accurate price.

Timing of sale

As a mortgagee has no duty to enforce its securities promptly or at all, similarly the mortgagee is entitled to decide when to sell and, generally, how to sell. A mortgagee is not required to wait for a time when an owner, selling in his own interests, might consider to be an ideal time.[38] A mortgagee is not obliged to wait for a depressed market to rise or to delay sale where there is a falling market[39]. However, if it is apparent that the market is about to rise, then there may be an obligation to wait.[40]

There may be factual circumstances where the failure to act promptly when it is apparent that the market is in decline and where it is also apparent that there is a

willing buyer, amounts to a breach. In order to show that a loss was incurred in these limited circumstances, it would be important to establish that there was a breach and that there was a willing buyer prepared to buy at a certain price – otherwise the mortgagee would effectively be held liable for the decline in the market rather than a breach of duty.[41]

In one case, the court found that the mortgagee ought to be liable for loss caused by delay where the mortgagee delayed because of legal conflicts with the mortgagor about matters which were not directly related to the sale of the property. The court found that, had the property been sold more quickly, the amount obtained would probably have exceeded the debt rather than leaving a shortfall.[42]

Industry practice

In accordance with the Terms of Reference, when investigating disputes about mortgagee sales, ABIO will consider the particular bank's procedures and also what is regarded as good industry practice.

Assessment of loss

Our usual approach in cases where it appears that there has been a breach of the applicable duty is to require compensation calculated as the difference between the actual sale price and what we consider to be the market value. If we are issuing a Finding or Recommendation then it a specific market value will be identified either with the assistance of an ABIO engaged valuer or by reference to information on file.

It is reasonable to allow an amount to cover the mortgagee's auction and/or other sale related costs to be recovered subject to the comments made above as to the reasonableness of those charges. [43]

If a payment is made to the disputant, interest for loss of use should also be paid in accordance with the approach set out on page 65 of the Guidelines to the Terms of Reference. If there has been a shortfall then the account should be adjusted as if the amount received on sale was higher.

Questions

The following list reflects the questions ABIO asks when assessing a mortgagee sale dispute. The list arises from the above discussion and is also based on the current Polices and Procedures folder (pages 134 - 135). The list has been expanded and modified.

Issues after possession is taken

Repairs

1. Did the financial services provider carry out necessary repairs and maintenance having regard to the costs?

Insurance

2. Did the financial services provider make sure that the property was adequately insured?

3. If the premises were left vacant, did the financial services provider give any necessary notification to the insurer?

4. Did the financial services provider act reasonably in deciding whether to obtain insurance cover for fire or burglary or public risk?

Protection

5. Did the financial services provider take measures which were reasonable in the circumstances to protect the property from unauthorised entry or damage by vandals?

Rents and Profits

6. Did the financial services provider account for any rents and profits received from the property?

The sale process

Preparations for the sale

7. Did the financial services provider obtain at least one sworn valuation, preferably from an external valuer?

8. Did the financial services provider obtain at least one market appraisal from a real estate agent which includes matters such as a suggested market value, recommendations for the conduct of the sale of the property, a marketing program, recommendations for advertising, details of any work required to prepare the property for sale and any potential problems with the sale or marketing of the property;

9. Did the financial services provider appoint an agent and provide detailed instructions as to the conduct of the sale? During the sale period did the financial services provider review the agent's handling of the sale and provide further instructions if required?

Extent of advertising

10. Did the financial services provider ensure that the advertising was sufficient in the circumstances taking into account the marketing proposal, the usual forms of advertising for the property and in the locality and any expert advice?

11. Did the financial services provider approve the proposed advertising?

Ascertaining value and the reserve

12. Did the financial services provider take reasonable steps to ascertain the value of the property before selling?

13. Did the financial services provider specify a reserve based on the contents of a well supported sworn valuation and the advice of the agent taking into account any knowledge it held about the value of the property?

Timing of the sale

14. Did the financial services provider sell at an appropriate time having regard to its own interests, the fact that it was not required to wait for a depressed market to rise and any other information relating to the timing of the sale?

Method of sale

15. Did the financial services provider sell by auction and if not, what were the reasons for selling by private treaty?

The sale

16. Did the financial services provider obtain market value taking into account the available information as to that value and all of the circumstances surrounding the sale?

Conduct after sale

17. If the property did not sell at auction or within approximately 30 days of the auction or of listing in the case of sale by private treaty, did the financial services provider re-assess the selling program and consider listing with another or a number of other agents?

Industry practice

18. Did the financial services provider act in accordance with its own procedures at all relevant times? Are those procedures consistent with good industry practice?

Breach of duty?

See question for applicable duty:

Common law - Did the financial services provider act in good faith and without a reckless or wilful disregard for the interests of the mortgagor?

Queensland – Did the financial services provider take reasonable care to ensure that it sold at the market value?

Victoria/Tasmania – Did the financial services provider act in good faith and having regard to the interests of the mortgagor?

Corporate – Did the financial services provider take all reasonable care to sell the property for not less than the market value of the property?

As always, we welcome feedback on the contents of this Bulletin.

Colin Neave
Australian Banking Industry Ombudsman

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[1] See *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] 1 Ch 949; *Standard Chartered Bank Ltd v Walker* [1982] 3 All ER 938 but note that in relation to guarantors the approach may be based in contract – see *China and South Sea Bank Limited v Tan* [1990] 1 AC 536 and Bryson J's comments at paras 68-71 in *GE Capital Australia v Davis & Ors* [2002] NSWSC 1146

[2] *Citicorp Australia Ltd v McLoughney* (1984) 35 SASR 375; *Wenham v General Credits Ltd* (Unreported 16 December 1988 per Rogers CJ); NAB v Sproule (1989) 17 NSWLR 505; *Bourke v Beneficial Finance Corporation Limited* (Unreported 30 January 1991, per Hill J); *GE Capital Australia*; *Brutan Investments Pty Ltd v Underwriting & Insurance Ltd* (1980) 39 ACTR 47; *Gomez v State Bank of NSW Ltd* [2002] FCA 442

[3] *Pendlebury v Colonial Mutual Life Assurance Society Ltd* (1912) 13 CLR 676

[4] See J O'Donovan *Lender Liability* Law Book Company 2000 at page 673 referring to *Commercial and General Acceptance Ltd v Nixon* (1981) 38 ALR 225 at 241 per Aicken J

[5] See *Pendlebury* per Griffith CJ at 679-680 quoting the decision of Lord Herschall LC in *Kennedy v De Trafford* (1897) AC 180

[6] *Duggan v Thomas (In the matter of William Joseph Duggan)* [2002] FCA 830; *GE Capital Australia v Davis & Ors* [2002] NSWSC 1146 (guarantors); *Alliance Acceptance Co Ltd v Graham* (1974) 10 SASR 220; *Southern Goldfields Ltd v General Credits Ltd* (1991) 4 WAR 138 (subsequent mortgagees)

[7] *Commercial & General Acceptance Ltd v Nixon* (1981) 38 ALR 225

[8] *Higton Enterprises Pty Ltd v BFC Finance Ltd* [1994] QCA 14

[9] *Goldcel Nominees Pty Ltd v Network Finance Ltd* [1983] 2 VR 257 at 261-262

[10] See *National Transport Insurance v Smith* [2001] NSWSC 1046 and Shane Maudrell's article "National Transport Insurance v Smith" Australian Banking and Finance Law Bulletin Volume 18 No 1, June/July 2002

[11] *Higton Enterprises Pty Ltd*

[12] *Kyuss Express Pty Ltd v Sellers* (2001) 37 ACSR 62 per Mandie J

[13] (1907) 5 CLR 418 at 431 per Griffith CJ

[14] *McKean v Maloney* [1988] 1 Qd R 628
[15] *API Professional Practice 2002 Instructing Valuers – A Guide for the Mortgage Industry*
[16] See further the API guidance note and also O'Donovan, Ibid at page 689
[17] *Pendlebury* (common law); *Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd* [1976] VR 309 (Victoria); *Commercial & General Acceptance v Nixon* (Qld); *Jeogla v ANZ Banking Group* (corporate)
[18] per Griffith CJ at 687
[19] *Commercial & General Acceptance Corporation Ltd v Nixon* (1981) 38 ALR 225 at
[20] at 233
[21] *Commercial and General Acceptance Ltd v Nixon* (1981) 152 CLR 491 per Connolly J – this view was not overturned by the Full Court of Queensland or the High Court
[22] For examples see *Carver v Westpac Banking Corporation* [2002] NSWCA 415 and *State Bank of New South Wales v Kissner (*Unreported, Supreme Court of New South Wales, 12 November 1998, per Macreadie M)
[23] *Pendlebury, Commercial and General Acceptance Ltd v Nixon*, per Connolly J. As to knowledge of planning issues see *Carver v Westpac Banking Corporation* [2002] NSWCA 415
[24] See *Pendlebury* per Griffith CJ at 683 (common law); *Henry Roach (Petroleum)* at 313 (Victoria); *Kyuss Express Pty Ltd* (corporate)
[25] at 683
[26] (Unreported, Supreme Court of NSW, Cohen J, 6 October 1993)
[27] *Pendlebury* per Isaacs J at 701.
[28] *Pendlebury* per Isaacs J at 701
[29] *Australian and New Zealand Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd* (1978) 139 CLR 195 at 227
[30] *Sewell v Agricultural Bank of Western Australia* (1930) 44 CLR 104
[31] This would be similar to the facts which arose in the cases of Goldcel Nominees, ANZ Banking Group v Bangadilly Pastoral Co Pty Ltd and Cameron.
[32] *Pendlebury* – the bank was held liable for the acts of the agent including disclosing the reserve (common law); *Goldcel Nominees* (Victoria)
[33] *Pendlebury* per Isaacs J at 701
[34] For example see Tyler, Young & Croft *Fisher and Lightowood's law of Mortgage*, Australian Edition, 1995 at para [19.39]
[35] *Henry Roach (Petroleum)*; *Forsyth v Blundell; Goldcel Nominees*
[36] *Cameron*
[37] at para 50
[38] *Henry Roach (Petroleum)*
[39] *Bank of Cyprus (London) Ltd v Gill* [1980] 2 Lloyds Rep 51 (rising market); *Pendlebury* (falling market)
[40] *Dimmick v Pearce Investments Pty Ltd* (1980) 43 FLR 235
[41] See *Higton Enterprises* per Pincus JA at page 12-13
[42] *Farrow Mortgage Services Pty Ltd (in liq) v Torpey* (Unreported, Court of Appeal, NSW, 22 April 1998, per Mason P, Priestley and Sheller JJA)
[43] See *Pendlebury*