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Mortgagees' Power of Sale

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14. Licensing a Responsible Entity *20 March 2008**
15. Proportionate Liability in claims against Valuers *29 Oct 2008**
16. Examinations under the Corporations Act and ASIC Act *5 March 2012[†]*

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A. The source of the power of sale

1. Old system legal mortgages

An Old System Title first mortgagee was the owner of the land at law. The mortgagor had no legal interest, merely an equity of redemption. Thus an Old System first mortgagee could sell (or beneficially retain without selling) the security as the legal owner of that land, but could not do so until the mortgagor's equity of redemption was first extinguished.

The extinguishment of the equity of redemption was achieved through a foreclosure suit brought by the mortgagee. In an Old System foreclosure suit, the court determined the amount that the mortgagor owed and then gave the mortgagor a period (almost invariably six months) to pay the monies owing, in default of which the equity of redemption was extinguished and the first mortgagee became absolute owner of the land.

2. Old system equitable mortgages

An Old System equitable mortgage was a mortgage of the mortgagor's equity of redemption (in the case of a second or subsequent mortgage) or an imperfect legal mortgage.

The mortgagee had no power of sale because it lacked the ability to convey a legal title to a purchaser see *Guardian Mortgages v Miller*¹, which followed *Re Hodson and Howes' Contract*². However if the problem of conveyance to a purchaser was solved by the grant to the equitable mortgagee of a power of attorney or through the device of a vesting order pursuant to a deed of trust an equitable mortgagee could then exercise a power of sale.

3. Company title mortgages

"Company title" is a scheme whereby the land is owned by a company, with the shareholders of the company owning specific allotments of shares. Each allotment of shares carries with it the right to occupy a specified portion of the building (the apartments). Company title predated the strata title as a means of distributing the ownership of an apartment or office block. Many older apartment buildings are still owned by company title.

A person occupying an apartment pursuant to company title is unable to mortgage the land (as they do not own any part of the land). However they may mortgage the shares. The mortgage is thus a chattels mortgage and is not governed by the Real Property Act.

Typically as part of the mortgage the mortgagee will hold, as a security document, an executed transfer of the shares (with the transferee left blank). Subject to the articles of incorporation (some articles require that the proposed purchaser be approved by the

¹ [2004] NSWSC 1236

² (1887) 35 Ch D 668

other owners) this can be used to transfer ownership of the shares to the purchaser. The power to sell is thus contractual.

4. Torrens title legal mortgages

Under the Torrens System a registered mortgage is a legal mortgage. The mortgage acts as a charge (rather than a conveyance of the title). The mortgagee obtains the power to sell by virtue of section 58 of the Real Property Act, which reads:

1. Where a mortgagee... is authorised by section 57 (2) to exercise the powers conferred by this section, the mortgagee... may sell the land mortgaged either altogether or in lots by public auction or by private contract, or both such modes of sale, and subject to such conditions as the mortgagee... may think fit, and to buy in and resell the same without being liable for any loss occasioned thereby, and to make and execute all such instruments as shall be necessary for effecting the sale thereof, all which ... shall be as valid and effectual as if the mortgagor, ... had made, done, or executed the same, and the receipt or receipts in writing of the mortgagee... shall be a sufficient discharge to the purchaser of such land, ... for ... the purchaser's purchase money ...
2. No such purchaser shall be ... obliged to see to the application of the purchase money ... nor shall the purchaser be concerned to inquire as to the fact of any default or notice having been made ... as referred to in section 57 (2).
3. The purchase money ... shall be applied, first, in payment of the expenses occasioned by such sale; secondly, in payment of the moneys which may then be due or owing to the mortgagee...; thirdly, in payment of subsequent mortgages... in the order of their priority; and the surplus (if any) shall be paid to the mortgagor...

The power thus arises pursuant to section 58 but only upon the preconditions in section 57(2) being satisfied (see below).

5. Torrens title equitable mortgages

Any mortgage of Torrens System land which is unregistered is equitable. The status of an equitable mortgagee of Torrens System land is similar to that of an Old System equitable mortgagee. This is because the Real Property Act does not confer any powers on an equitable mortgagee (as that Act requires registration of a mortgage before the provisions of the Act can be invoked in favour of that mortgage).

Absent a power of attorney from the mortgagor, an equitable mortgagee cannot convey a legal title over the security to a purchaser. Thus the equitable mortgagee wishing to sell land must either do so by the device of a power of attorney or obtain the assistance of the Supreme Court in the form of orders for judicial sale of the property.

As Wood CJ in CL notes in *Guardian Mortgages v Miller*³:

³ [2004] NSWSC 1236 at [121]

In *Yarrangah Pty Ltd v National Australia Bank Ltd* (1999) 9 BPR 17,061, Young J held that although section 103 of the Conveyancing Act was not applicable to Real Property Act land, there is an inherent power in a Court of Equity to order judicial sale with respect to Real Property Act land in circumstances analogous to those where an order for sale under section 103 would be available in relation to Old System land. It follows that the Plaintiff requires the assistance of an order of the Court for judicial sale, analogous to an order for sale under section 103 of the Conveyancing Act.

Campbell J in *King Investment Solutions v Hussain*⁴ followed both *Yarrangah* and *Guardian* and confirmed the Supreme Court's jurisdiction to order sale at the suit of an unregistered mortgagee of Real Property Act land, although his Honour suggested that the Court should consider carefully the circumstances of a given case before granting such an order, and that the interests of any registered mortgagee in particular should be examined.

Thus the Supreme Court has an inherent power to make orders for judicial sale of land. Of course, the equitable mortgagee seeking that the court make such orders must show an entitlement to the court's assistance. Thus the equitable mortgagee needs to demonstrate a contractual entitlement to sale of the property.

Most mortgages contain an express term allowing the mortgagee to sell the property on default. If no such term is included in a mortgage, the term is nevertheless implied into the mortgage by section 109(1)(a) of the Conveyancing Act, which reads:

- (1) A mortgagee ... shall by virtue of this Act have the following powers to the like extent as if they had been in terms conferred by the instrument creating the mortgage ... but not further, namely:
 - (a) A power to sell ... the mortgaged ... property ... either subject to prior charges or not... by public auction or by private contract... and to buy in at an auction or to rescind any contract for sale, and to resell without being answerable for any loss occasioned thereby.

Section 108 of the Conveyancing Act makes clear that section 109 applies also to Real Property Act land.

A declaration by the mortgagor that the mortgagor holds the security on trust in favour of the equitable mortgagee allows the mortgagee, as beneficiary of the trust, to apply to the Supreme Court for an order under section 70 of the Trustee Act 1925 for the appointment of a new trustee in lieu of the mortgagor and a vesting order under section 71 of that Act vesting the security in the new trustee. This is a device that can be used to effect a transfer of the security by the equitable mortgagee to a purchaser, as the mortgagee can seek the appointment of the purchaser as the new trustee and an order of the Supreme Court that the property be vested in the purchaser as trustee, and then the mortgagee can complete the sale by transferring the mortgagee's equitable

⁴ [2005] NSWSC 1076

interest by way of a deed (see *London and County Banking Company v Goddard*⁵). However in Torrens System land Supreme Court orders are required. This is because without the Court's vesting order the equitable mortgagee is unable to effect a change on the register, which is the very essence of ownership under the Torrens System.

The trust procedure is rather cumbersome and smacks of a sham (in so far as the trust may be seen merely as a device and not the genuine essence of the transaction). Accordingly there is nothing to recommend it in the circumstances where the equitable mortgagee can obtain relief by the now common application for judicial sale orders. Further, a mortgagee seeking to transfer the security through a trust may only transfer it subject to other interests, so if the purchaser requires a clear title then the transfer can only be transferred after all other interest holders have either been paid out or had their caveats lapsed.

B. Notices & preconditions before exercising power of sale

1. Registered mortgages

The power of sale of a registered mortgagee of Torrens System land does not arise until there has, firstly, been a default under the mortgage and, secondly, section 57(2) of the Real Property Act has either been complied with (or effectively dispensed with). In relation to monetary defaults the mortgagee is obliged to serve a section 57(2)(b) notice and wait one month for it to expire; in relation to non-monetary defaults, the mortgagee may dispense with notice if the mortgage so provides. Other legislation, such as the Consumer Credit Code and the Farm Debts Mediation Act, impose additional statutory preconditions to sale.

With respect to non-monetary defaults the need to serve a section 57(2)(b) notice can be contracted out of under section 58A of the Real Property Act, but that same section invalidates any attempt to contract out of providing notice with respect to a monetary default.

While section 58 contains the statutory power of sale of a registered mortgagee of RPA land, neither section 58 nor any other section of the Real Property Act, states that a registered mortgagee cannot sell land except by way of the power conferred by section 58. This opens the possibility of a sale by a power of attorney and the avoidance of the requirements of section 57.

Sales outside of the RPA are governed by section 111 (1) of the Conveyancing Act which reads:

- (1) In case of a mortgage ... registered under the Real Property Act 1900, the mortgagee ... shall only exercise the power of sale conferred by this Act in the events and subject to the conditions contained in sections 57, 58 and 58A of that Act, and the provisions of section 59 of that Act shall apply to any transfer executed for the purpose of such sale.

Thus any power of sale conferred by the Conveyancing Act can only be exercised when the statutory power of sale under RPA section 58 is also exercisable.

⁵ [897] 1 Ch 642

Section 109(1) of the Conveyancing Act implies a power of sale into any mortgage, provided no contrary intention is shown in the mortgage. Although section 109(2) enables the powers in subsection (1) to be varied or extended by the words of the mortgage, this variation or extension is to “operate in the like manner and with all the like incidents, effects, and consequences as if such variations or extensions were contained in this Act”. It follows that even if there is a contractual power of sale in the mortgage, this power will be treated as a power of sale conferred by the Conveyancing Act, which will mean that section 111(1) will exclude its exercise otherwise than in accordance with sections 57,58 and 58A of the Real Property Act.

The result is that a mortgagee cannot avoid section 57 of the Real Property Act by attempting to sell the security by virtue of a power of attorney rather than through exercise of the statutory power of sale conferred by RPA section 58.

2. Equitable mortgages

A judicial sale application may not be made prior to default (which default has not been rectified at the time proceedings had commenced) under the mortgage. There is no other precondition to commencing judicial sale proceedings unless there is a contractual precondition in the mortgage (most commonly a requirement to serve some sort of default notice), or the mortgage comes within the ambit of legislation such as the Consumer Credit Code or the Farm Debts Mediation Act (which imposes statutory preconditions to a suit)

Associate Justice Macready in *King Investment Solutions Pty Ltd v Hussain*⁶ considered the argument that a notice under section 111 of the Conveyancing Act or section 57 of the Real Property Act needed to be served (and have its one month period expire) prior to commencement of proceedings for judicial sale. In that case a notice referring to both sections had been served and had expired prior to the hearing of a motion for summary judgment including judicial sale orders, but the notice had been served with the Statement of Claim immediately after commencement of the proceedings, rather than more than a month prior to commencement. His Honour found, at page 5, that “When one looks at the sections plainly ... they do not apply because here no power of sale is being exercised by the mortgagee”. Thus he found the sections deal with the exercise of a statutory power of sale by the mortgagee, whereas in a judicial sale application the mortgagee is not relying upon any statutory power, but rather is requesting the court to exercise its discretion to order the property be sold in aid of the mortgagee.

His Honour then noted the argument made on behalf of the mortgagor, that the mortgagor under an equitable mortgage should be accorded the same opportunity as a mortgagor under a legal mortgage is accorded under section 57 to remedy the default before sale, stating:

Effectively the purpose of the section is to give notice so that the default can be remedied Notice has been given and there was protection because it was not until later that the notice of motion was served seeking orders by way of summary judgment.

⁶ 1 August 2005 (unreported)

Thus his Honour found that service of a section 111/section 57 notice was not a precondition to bringing judicial sale proceedings, but there was a suggestion that service and expiry of such a notice does need to occur prior to the making of the judicial sale orders.

The decision of Macready J was appealed, and the appeal heard by Campbell J in *King Investment Solutions v Hussain*⁷. His Honour agreed that there was no statutory requirement for default notices, and said at [84]:

The notices required by those sections are statutory preconditions for the exercise of the power of sale conferred by, respectively, section 58 Real Property Act 1900, and section 109 Conveyancing Act 1919. Each of those sections are ones which confer on a mortgagee power to sell the mortgaged property out of court. The exercise of the Court's equitable jurisdiction to order a sale of mortgaged property does not depend upon the service of notices under those statutory provisions. I respectfully agree with *Guardian Mortgages v Miller* [2004] NSWSC 1236 at [86] in this respect.

Prior to Campbell J's decision in *King Investment Solutions* it had been the practice in the Supreme Court to require an applicant for judicial sale orders to notify in writing any prior interest holder in the property (usually one or more registered mortgagees) of the date upon which the applicant is seeking judicial sale orders so that the interest holder has an opportunity to oppose the orders in the event if desired. Campbell J, however, found that this procedure was not sufficient to protect the registered mortgagee's interest and that the registered mortgagee should instead be made a party to the judicial sale proceedings.

The *King Investment Solutions* decision established that there is no statutory requirement to serve default notices in judicial sale proceedings. However a Court may decline to exercise its discretion in relation to granting the equitable relief of judicial sale on the basis that the Court does not consider that the mortgagor has been given a proper opportunity to remedy his default.

The Court would in effect be exercising its discretion to refuse to grant the equitable remedy of judicial sale in circumstances where the mortgagor had not received the same opportunity to remedy the default as would have been accorded to a mortgagor under a registered mortgage. Although the fact that a mortgagor might have expressly agreed in a mortgage to forgo such notice, that would not necessarily remove the element of unfairness in the circumstance where it is notorious that persons entering into complex agreements are often unaware of many of the provisions.

It may very well be that the Court would insist upon the service and expiry of a default notice prior to granting judicial sale orders to ensure that this equitable relief did not become a device to avoid the notification requirements imposed by statute. No case has yet arisen, however, where this has occurred.

⁷ [2005] NSWSC 1076

3. Pursuant to special covenants

Some mortgages contain a provision to the effect that the mortgagee is obliged to give a defaulting mortgagor a notice of the default and then cannot take any action on the default until a period of one month has elapsed from the service of the notice without the default being rectified. As far as the mortgagee is concerned such mortgages are poorly drafted as they not only fail to dispense with notice for non-monetary defaults, if the mortgage is unregistered a notice requirement is imposed by contract where it would not otherwise exist.

Those mortgages incorporating Memorandum Q860000 (or including text copied from that popular memorandum) subject an unregistered mortgagee to the same notice regime as a registered mortgagee. Clause 5 reads:

Upon default being made in payment at the respective times and in the manner shown in the mortgage of the principal sum or any part thereof, or of the interest thereon or any part thereof, or upon default being made in the observance or performance of any of the covenants contained herein or in the mortgage or implied therein by the Real Property Act 1900 or the Conveyancing Act 1919 the mortgagee shall (notwithstanding any omission, neglect or waiver of the right to exercise all or any of such powers on any former occasion) be at liberty to exercise all or any of the powers of a mortgagee under the said Acts immediately upon or at any time after default as herein before mentioned, subject however to compliance with any requirements of the said Acts in respect of the exercise of such powers. If at any time default shall be made in the due payment of the interest on any of the days when the same respectively shall become payable or within the time thereafter mentioned in the schedule to the mortgage, or, if the power of sale given to the mortgage under either of the said Acts shall become exercisable, then the principal sum shall immediately become due and the mortgagor will thereafter pay the same on demand.

The above clause does not benefit the mortgagee by conferring by contract the powers already granted under the Real Property Act and Conveyancing Act, it instead makes those powers conditional upon the mortgage complying with the requirements of those Acts. It may well be that such a clause would be construed as committing an unregistered mortgagee to service of a section 111/ section 57 notice as a precondition to commencing proceedings for judicial sale orders.

4. Required by the Consumer Credit Code

Section 80 of the Consumer Credit Code prevents the mortgagee from beginning enforcement proceedings, taking possession of, selling, foreclosing upon, or appointing a receiver with respect to property subject to a mortgage unless:

1. The mortgagor is in default;
2. A notice under that section has first been served on the mortgagor allowing the mortgagor a period of at least 30 days to remedy the default; and
3. The default has not been remedied within the stated period following the receipt of the notice.

The notice is required to “specify the default and the action necessary to remedy it and that a subsequent default of the same kind that occurs during the period specified in the default notice for remedying the original default may be the subject of enforcement proceedings without further notice if it is not remedied within the period”. If the default is not capable of being remedied, then the mortgagee merely needs to specify the default in the notice (not a mode of remedying it or a period for doing so), and then may enforce the mortgage after 30 days from service of the notice (see section 80(5)).

There is also a separate requirement under section 80 to serve a debtor with a default notice prior to beginning enforcement proceedings against the debtor. A notice to a debtor must also be served on all guarantors of the debt. Section 80 (3A) permits the notice to the debtor to be combined with the notice to the mortgagor if those persons are one and the same.

Section 169 of the Code voids any contractual provision seeking to avoid or modify the code. It is therefore not possible to contract out of section 80 of the Code. However there are certain circumstances prescribed by section 80(4) where the section 80 notice procedure is not required. Section 80(4) reads:

A credit provider is not required to give a default notice or to wait until the period specified in the default notice has elapsed, before beginning enforcement proceedings, if:

- a) the credit provider believes on reasonable grounds that it was induced by fraud on the part of the debtor or mortgagor to enter into the credit contract or mortgage; or
- b) the credit provider has made reasonable attempts to locate the debtor or mortgagor but without success; or
- c) the Court authorises the credit provider to begin the enforcement proceedings; or
- d) the credit provider believes on reasonable grounds that the debtor or mortgagor has removed or disposed of mortgaged goods under a mortgage related to the credit contract or under the mortgage concerned, or intends to remove or dispose of mortgaged goods, without the credit provider's permission or that urgent action is necessary to protect the mortgaged property.

Section 80 (6) provides:

This section is in addition to any provision of any other law relating to the enforcement of real property or other mortgages and does not prevent the issue of notices to defaulting mortgagors under other legislation. Nothing in this section prevents a notice to a defaulting mortgagor under other legislation being issued at the same time, or in the same document, as the default notice under this section.

It is thus clear that a mortgagee can combine a section 80 notice with another default notice without prejudice to the mortgagee’s rights under the Code. The other notice

could only be a section 57 or section 111 notice, as they are the only notices in similar terms to a section 80 notice. To combine the notices, it is necessary to provide a period to remedy the default of no less than one month and no less than 30 days in order to comply with the provisions of the RPA, the Conveyancing Act and the Code. Thus the notice should specify a period of 31 days to avoid difficulties in those months of 28, 29 or 31 days' duration.

5. Required by the Farm Debt Mediation Act

The principal operative section of the Farm Debt Mediation Act is section 8, which reads:

- 1) A creditor to whom money under a farm mortgage is owed by a farmer must not take enforcement action against the farmer in respect of the farm mortgage until at least 21 days have elapsed after the creditor has given a notice to the farmer under this section.
- 2) Notice to the farmer is to be in writing in a form approved by the Authority (informing the farmer of the creditor's intention to take enforcement action in respect of the farm mortgage and of the availability of mediation under this Act in respect of farm debts).
- 3) This section does not apply if a certificate is in force under section 11 in respect of the farm mortgage concerned.

The certificate under section 11 referred to is a certificate that is issued after a mediation process has been concluded, and such certificate lasts for 3 years. Thus a creditor may be excused from issuing a section 8 certificate if a mediation has previously taken place within the preceding 3 years and the creditor obtained a section 11 certificate.

Section 20 of the Farm Debt Mediation Act not only voids any provision of any agreement that purports to contract out of the operation of the Act, but also makes the creditor guilty of an offence if the creditor is party to such an agreement.

Section 8 only prohibits enforcement action against a farmer. A creditor is thus free to proceed against non-farmer guarantors of a farm debt.

If there is a single mortgage containing both farm and non-farm securities owned by a farmer, the creditor is precluded from proceeding against any of the securities other than in compliance with section 8 of the Act. That is because section 4 of the Act defines "enforcement action" as follows:

"enforcement action", in relation to a farm mortgage, means taking possession of property under the mortgage or any other action to enforce the mortgage, including the giving of any statutory enforcement notice, or the continuation of any action to that end already commenced...

The creditor, who is precluded from taking any enforcement action against the farmer in respect of the farm mortgage other than in accordance with section 8, is thereby precluded from taking from the farmer possession of any property under the mortgage, even if the property is a non-farm property.

In a case, however, where a farmer has entered into several different mortgages to a creditor, some being over farm and some over non-farm properties, then the creditor could enforce any of the mortgages that were over only non-farm properties without the need to comply with the provisions of section 8.

6. Required before selling under an expired mortgage

Section 92(1) of the Conveyancing Act states:

Where the mortgagor has made default in payment of the principal sum at the expiry of the term of the mortgage, or of any period for which it has been renewed or extended, and the mortgagee has accepted interest on the said sum for any period (not being less than three months) ... then, so long as the mortgagor performs and observes all covenants expressed or implied in the mortgage, other than the covenant for payment of the principal sum, the mortgagee shall not be entitled to take proceedings to compel payment of the said sum, or for foreclosure, or to enter into possession, or to exercise any power of sale, without giving to the mortgagor three months' notice of his or her intention so to do.

Section 92 only applies in the uncommon situation where the mortgagor's only default is in repayment of principal (in other words the interest payments are being regularly made) and the mortgagee has allowed the default in repayment of principal to continue for 3 months or more after the principal fell due. If this occurs, the mortgagee cannot attempt to enforce the mortgage without first giving to the mortgagor 3 month's notice.

C. Factors effecting the validity of Notices

1. Form of the notice

i) Amount owing

Overstatement of interest does not necessarily invalidate a statutory notice. In *Clare Morris Ltd v Hunter BNZ Finance Ltd*⁸, Waddell CJ in Eq cited the decision of the High Court in *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd*⁹ where it was said, obiter dicta:

Even a notice given to the mortgagor by the mortgagee as a condition precedent of a power of sale is not rendered invalid because it demands payment of more than is due.

Waddell CJ cited also the consideration by the Full Court of the Queensland Supreme Court in *Clarke v Japan Machines (Australia) Pty Ltd*¹⁰ and the comments by Campbell J where he noted that "An error in specification of the appropriate sum will not be the end of the matter....".

⁸ SC (NSW), unreported, 21 April 1988, BC8802005

⁹ (1984) 153 CLR 491 at 504

¹⁰ [1984] 1 Qd R 404

If the amount of interest stated in a statutory notice is greatly in excess of the amount actually due, this may invalidate the notice. *In Manton v Parabolic Pty Ltd*¹¹, Young J stated that “There have been a series of cases dealing with the significance of a misstatement in a notice under section 111 of the amount which needs to be paid by the mortgagor to remedy his default.” He then referred to *Clarke v Japan Machines (Australia) Pty*¹² and said at page 377:

All the relevant cases in this State and elsewhere in Australia and New Zealand were reviewed in Clarke’s case and the conclusion reached by the Queensland Full Court (at 413) is

“...an error in specification of the appropriate sum will not be the end of the matter. A question of fact and degree is involved in every case. The most relevant factors determining validity will be the extent of the error, and the capacity of the notice to give the mortgagor a reasonable opportunity to do what he is obliged to do.”

Waddell CJ in *Clare Morris* (supra) noted that:

There is a prima facie case that the amount claimed is considerably in excess of that actually due and there is evidence raising a prima facie case of an implied refusal to accept any less. In these circumstances there is, I think, a prima facie case that the section 57 notice is invalid on the ground that the amount claimed is substantially more than that due.

Failing to state the amount due in a statutory notice does not invalidate it, provided that the mortgagor has knowledge of the amount by other means: *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd*¹³; *AGC (Advances) Ltd v Tweed Canal Estates Pty Ltd*¹⁴.

Similar considerations would presumably apply also to a notice under section 80 of the UCCC.

As with interest, mere misstatement in a statutory notice of the amount of principal owing does not necessarily invalidate that statutory notice, but invalidity may occur if the misstatement is large. Failure to state the amount of principal is similarly not a source of invalidity provided the mortgagor is aware of the amount in any event. In each case see the authorities previously quoted with respect to interest.

A notice claiming principal when no principal has yet fallen due will be invalid: *Krey v National Australia Bank*¹⁵. A mortgagee should thus be vigilant in drafting statutory notices in cases where the term of the loan has not yet expired at the time the notice is sent, because even if the mortgage contains a provision that the principal can be claimed immediately upon any default, section 57(5) of the Real Property Act precludes (at least in the typical case of a monetary default) such provision from

¹¹ (1985) 2 NSWLR 361

¹² [1984] 1 Qd R 404

¹³ (1984) 153 CLR 491

¹⁴ (1988) 4 BPR 9404

¹⁵ (1992) NSW ConvR 55-653

taking effect until a section 57(2)(b) notice has been served and run its course unsatisfied; in such a case the mortgagee should not include the principal in the section 57(2)(b) notice, but rather should claim the principal in a separate document sent to the mortgagor after the period of one month has elapsed from service of the section 57(2)(b) notice (assuming that notice has not been satisfied within the one month period).

Similar considerations would also apply to a notice under section 80 of the UCCC.

ii) Time for rectification of the default

A statutory notice that provides any shorter time for compliance than period of one month (or such greater period that may be provided in the mortgage) prescribed by section 111 of the Conveyancing Act and section 57 of the Real Property Act is invalid.

A notice giving one month from its date instead of one month from service was held to be invalid by Brownie J in *State Bank of New South Wales v Topfelt Pty Ltd*¹⁶. His Honour held:

One can find in the books statements to the effect that the words of section 57 (and of analogous provisions, such as section 111 and section 129 of the Conveyancing Act 1919, and of similar provisions in the legislation of other places) are not to be read strictly, but these statements must be read in their contexts, and in the light of the plain legislative objective of giving to mortgagors (or lessees) the opportunity to rectify the relevant breach before the person giving the notice might go on to exercise an extreme remedy.... The notice given by State required Topfelt to pay a specified sum within one month of the date of the notice... but the notice was not served until a few days later, so that it gave Topfelt a shorter period of time than the section permitted, within which Topfelt might remedy its default. It does not seem to me that the decisions going to the validity of a notice claiming an excessive amount, or describing what needs to be done to remedy a default, are precisely to the point involved here, although they shed light on the correct approach.

That approach, His Honour went on to find, was that the shortened amount of time denied the mortgagor the privilege which the legislation gave it, namely a notice giving it a month to obtain and pay over the requisite sum of money. His Honour continued:

Whether a mortgagor complies with a statutory notice is a matter going to the very existence to the power of sale *Carr v Finance Corp of Australia Ltd* (1982) 150 CLR 139 at 151; so that a notice purporting to diminish the rights of a mortgagor, as distinct from overstating the amount said to be due or describing in imprecise but understandable terms the breach of the obligation on the part of the mortgagor required to be remedied, is a notice which does not give to the mortgagor the opportunity which the statute requires the mortgagee to give the mortgagor; and hence that notice does not enliven the power of sale.

¹⁶ SC (NSW), unreported, 11 March 1993, BC9302006)

The notice under section 80 of the UCCC serves a similar purpose to notices under section 57 and section 111, and thus, presumably, a similar rule would apply to such notices. It should be noted, however, that the statutory period for a section 80 notice is 30 days.

A notice under section 92 of the Conveyancing Act is somewhat different to any of the above notices, as it is not a default notice but rather a three month notice of intent to enforce a mortgage in the circumstances where the mortgagee has previously been content merely to accept periodic interest on an overdue mortgage. There is little law on the operation of this section, with the decision of Master Harrison in *JE & EJ Investments Pty Ltd v Masselos*¹⁷ being one of the few exceptions. Guidance must thus be sought from the more extensive authority on the equivalent New Zealand section, although as Master Harrison notes, the significant differences in drafting between the New South Wales section and the New Zealand section reduce the helpfulness of the New Zealand cases. The Master did not, however, determine the timing point in *JE & EJ Investments*, determining the notice in that case to be invalid on the grounds that it did not use language similar to that appearing in section 92.

In *Wallace McLean Bawden & Partners Nominees Ltd v Fish*¹⁸, the New Zealand Court of Appeal heard an appeal from a decision of Barker J where his Honour had found that a notice under the New Zealand section (section 90 of the Property Law Act 1952) had been given 1 day too early and was hence invalid. The Court of Appeal agreed with the proposition that the mortgagee was precluded from enforcement until the full three month period had expired, but disagreed with Barker J's calculation of time, finding that the three months notice had indeed been given.

It should be noted that the New Zealand section refers to the need for "three clear months' notice" whilst section 92 uses the expression "three months' notice", which might be argued indicates a less strict attitude towards timing in New South Wales than is the case in New Zealand. Given, however, not only the New Zealand precedent but the analogy that may be drawn with section 52 and section 111 notices, it is more likely than not that the three month period would be seen to be a strict minimum and section 92 notices giving less time would thus be invalid.

The notice period under section 80 of the Code is at the mortgagee's discretion, provided the period is not less than 30 days.

Section 92 of the Conveyancing Act requires the giving of "three months' notice" to the mortgagor, which should be construed as notice of no less than three months duration. Thus notice for more than three months would not invalidate such a notice.

RPA section 57 and section 111 of the Conveyancing Act both specify that a period of "one month" is to be used in notices under that section unless the mortgage specifies a longer period, and thus the specification of a period longer than one month might be considered a defect. Applying the general principles cited previously with respect to defects in such notices, however, such a "defect" in no sense derogates from the

¹⁷ (2002) NSW ConvR 58,213

¹⁸ [1980] 1 NZLR 540

debtor's statutory entitlement to have a period of one month to remedy a default, and thus the provision of extra time to the mortgagor over and above the one month statutory period would be unlikely invalidate the notice.

Section 57(2)(c) and section 111(2)(c) permit sale by a mortgagee after a notice is sent provided that "the requirements of the notice are not complied with within the time notified pursuant to subsection 3(d)". Subsection 3(d) in each case involves a notification of a period of one month for the rectification of the default unless the mortgage specifies a period longer than one month, in which case that longer period instead needs to be stated.

As discussed above, a notice wrongly specifying a period greater than that prescribed by subsection 3(d) would be formally defective, but provided that the defect was not to the mortgagor's detriment the defect would not invalidate the notice. Specifying a longer period than prescribed but then seeking to exercise power of sale in accordance with the statutory time period rather than as set out in the notice is potentially highly prejudicial to the mortgagor's interests, as it has the potential to deny the mortgagor his rights to satisfy the default by lulling him into a false sense of security as to the amount of time he has to effect that remedy. It is thus likely that in those circumstances the default notice would be considered invalid.

Advising a mortgagor that he has a longer time to satisfy the mortgagee's requirement than he would otherwise have can also give rise to an estoppel against the mortgagee insisting on its strict rights: see *Barns v Queensland National Bank Ltd*¹⁹.

In any event, it is strongly arguable that subsection 2(c) is to be construed as allowing the mortgagor the time in the notice rather than the statutory time period, as the subsection refers to the "time notified pursuant to subsection 3(d)"; the emphasis appears to be on the "time notified" as otherwise the provision would presumably have been drafted to refer to the "time prescribed by subsection 3(d)."

For UCCC section 80 notices, the Code only fixes the minimum time to be given in such notices, so if any longer period is specified by the mortgagee then the mortgagee is bound by that period.

2. Service of the notice

The mode of service of notices under sections 92 and 111 of the Conveyancing Act and section 57 of the Real Property Act is governed by section 170 of the Conveyancing Act, which states that service is valid if effected by any of the following means:

- a) if delivered personally,
- b) if left at or sent by post to the last known residential or business address in or out of New South Wales of the person to be served,
 - b1) in the case of a mortgagor in possession or a lessee, if left at or sent by post to any occupied house or building comprised in the mortgage or lease,

¹⁹ (1906) 3 CLR 925

- b2) in the case of a mining lease, if left at or sent by post to the office of the mine,
- c) if delivered to the facilities of a document exchange of which the person on whom it is to be served is a member, or
- d) in such manner as the Court may direct.

With respect to notices under section 80 of the Code, section 172 of the Code provides that such notices may be served as follows:

... the notice or other document may be given—

(a) to a natural person—

- (i) by delivering it to the person personally; or
- (ii) by leaving it at, or by sending it by post, telex, facsimile or similar facility to an appropriate address of the person; or

(b) to a body corporate—

- (i) by leaving it at the registered office of the body corporate with an officer of the body corporate; or
- (ii) by sending it by post, telex, facsimile or similar electronic facility to its registered office.

“Appropriate address” is then defined as the address previously nominated in writing by the mortgagor, or, if no such address, the mortgagor’s last known (to the mortgagee) place of residence.

Neither section 170 of the Conveyancing Act or section 172 of the Code provide that their provisions shall be the only valid means of service of notices, and they are thus not exclusive of any other means of service. Thus a corporate mortgagor can be served in the fashion set out in section 109X (1) of the Corporations Act, being as follows:

For the purposes of any law, a document may be served on a company by:

- (a) leaving it at, or posting it to, the company's registered office; or
- (b) delivering a copy of the document personally to a director of the company who resides in Australia or in an external Territory; or
- (c) if a liquidator of the company has been appointed—leaving it at, or posting it to, the address of the liquidator's office in the most recent notice of that address lodged with ASIC; or

- (d) if an administrator of the company has been appointed—leaving it at, or posting it to, the address of the administrator in the most recent notice of that address lodged with ASIC.

Any mode of service can be employed provided the notice comes to the attention of the mortgagor and the mortgagee is in a position to prove that fact - see *Senes & Sons Pty Ltd v Carige*²⁰.

Section 170 (4) of the Conveyancing Act provides with respect to the mode of service of notices under that Act and section 57 of the Real Property Act set out in section 170 (1):

This section applies only if and so far as a contrary intention is not expressed in any instrument, and shall have effect subject to the provisions of such instrument.

Thus a mortgage or other agreement can, by its terms, vary the mode of service of such notices as is seen fit.

As previously noted, section 169 of the Code prevents contracting out of the provisions of the Code. Thus the mortgage cannot vary the permissible means of service of a section 80 notice.

3. Proof of service

The onus of proof that a default notice was served lies with a mortgagee (assuming that the mortgagee needs to plead that fact in order to obtain the desired relief, for example if the mortgagee needs to demonstrate that it has validly accelerated the repayment of principal). In the case of notification by letter, however, in order to discharge its onus, the mortgagee needs only to demonstrate that the letter in question was correctly addressed, stamped and then posted; in such a case it is then presumed that the letter was received unless evidence is adduced by the intended recipient demonstrating otherwise, a mere failure by the intended recipient to recall receipt being insufficient evidence in this regard: see *Cushing v Lady Barkly Gold Mining Co*²¹.

If a notice is returned to sender, this fact is sufficient to rebut the presumption that the letter has been received by the intended recipient.

The modes of service specified in section 170 of the Conveyancing Act and section 172 of the Code involving service on the “last known” or “appropriate” address do not require the mortgagee to have any belief that the mortgagor still resides at the address in question or even that a notice served on such an address will ever come to the mortgagor’s attention.

If the mortgagee is relying on section 170(1)(b1) and is serving a notice on an occupied building subject to the mortgage, this is only effective service if there is a “mortgagor in possession”. This expression does not, however, connote the need for

²⁰ (1967) 70 SR (NSW) 95

²¹ (1881) 9 VLR (Eq) 108

actual occupation of the premises by the mortgagor, but rather refers to mortgaged premises of which the mortgagee has not yet taken possession.

Personal service is stated to be an acceptable mode of service under both section 170 of the Conveyancing Act and section 172 of the Code. Even if a mortgage expressly forbade personal service as a mode of delivery of notices (which would be a strange provision indeed to include in a mortgage), it is likely that personal service would nonetheless be valid given that service can be validly effected by any means provided the notice can be proved to have come to the actual attention of the intended recipient (*Senes & Sons Pty Ltd v Carige*²²) and personal service involves the document coming to the recipient's attention as a matter of course.

4. Waiver of notice by mortgagee

If a mortgagee, either expressly or by implication, makes a clear and unequivocal representation to a mortgagor that the mortgagee does not intend to rely on a notice, and the mortgagor, in reliance upon the representation, acts on the representation to the mortgagor's potential detriment if the representation is false, then the mortgagee is considered to have waived the notice and is thereby estopped from alleging that the notice has been given: see *Barns v Queensland National Bank Ltd*²³.

5. Waiver of notice by mortgagor

A mortgagor may waive the mortgagor's right to complain about the non-service or the defectiveness of a notice in a manner similar to the circumstances in which a mortgagee can waive its rights - the mortgagor makes a representation which the mortgagee relies upon to its potential detriment: see *Paterson v McNaghten*²⁴. This can be of benefit to a mortgagee in so far as if a mortgagor waives the mortgagor's right to contest the validity of a notice, the mortgagor is then estopped from relying on the invalidity of the notice in any subsequent proceedings in which that invalidity might otherwise have been an issue.

6. Lifespan of a notice under section 57(2)(b) of s111

If power of sale has arisen, the power of sale continues notwithstanding any sale contracts entered into which are not completed: see *United Hand-in-Hand and Band of Hope Co v National Bank of Australasia*²⁵.

7. Who needs to be served with the notice

Section 7 of the Conveyancing Act defines "mortgagor" as follows:

"Mortgagor" includes any person from time to time deriving title to the equity of redemption under the original mortgagor, or entitled to redeem a mortgage, according to the person's estate, interest, or right in the mortgaged property.

Thus whenever a notice under that Act needs to be served on a mortgagor, it must be served on all mortgagors.

²² (1967) 70 SR (NSW) 95

²³ (1906) 3 CLR 925

²⁴ (1905) 2 CLR 615

²⁵ (1877) 3 VLR (E) 61 at 70

Section 3 of the Real Property Act defines “mortgagor” in different terms:

"Mortgagor"—The proprietor of land or of any estate or interest in land pledged as security for the payment of a debt.

This definition, however, still requires all mortgagors to be served, as the mortgagors are collectively the proprietor of the security.

As for the UCCC, the only definition of “mortgagor” in Schedule 1 is:

“Mortgagor” includes a prospective mortgagor.

This definition is quite unhelpful. Prudence would dictate that the same interpretation is accorded to “mortgagor” as under the other Acts, and all mortgagors are served.

There is no requirement under section 57, section 92 or section 111 for any borrowers or guarantors to be served with a notice under those sections (unless, of course, such persons are also among the mortgagors).

Section 80 of the Code does not require notices to mortgagors under section 80(2) to be served on borrowers or guarantors, but as previously stated there is an additional precondition under section 80(1) to commencing enforcement proceedings against a debtor that a notice be sent not only to the debtor but to the guarantors. Thus if the mortgagor is the principal debtor and a combined default notice under subsections (1) and (2) is being sent, the guarantors would also need to be served with it.

RPA section 57(2)(b1) provides as follows:

- b1) where a notice is required to be served under paragraph (b), a copy of that notice has been served (in the manner authorised by section 170 of the Conveyancing Act 1919) on:
 - i) each mortgagee, chargee or covenant chargee (if any) of the land mortgaged or charged under a registered mortgage, charge or covenant charge which has less priority than that of the person intending to exercise the power of sale, and
 - ii) each caveator (if any) who claims as an unregistered mortgagee or chargee to be entitled to an estate or interest in the land mortgaged or charged

Thus with respect to a 57(2)(b) notice, a copy must be served on subsequent registered mortgages and charges and those unregistered mortgagees and chargees who have lodged a caveat. There is no requirement to serve prior registered mortgagees.

With respect to section 111 notices, section 111(2)(b1) of the Conveyancing Act reads:

where a notice is required to be served under paragraph (b), a copy of that notice has been served (in the manner authorised by section 170) on each mortgagee or chargee (if any) under a mortgage or charge to which the land is subject, registered in the General Register of Deeds (other than the mortgagee or chargee intending to exercise the power of sale)

As mortgages over Real Property Act land cannot be registered in the General Register of Deeds (see section 184 of the Conveyancing Act), section 111(2)(b1) is meaningful only in relation to Old System land. Equitable mortgagees seeking to serve notices under section 111 should instead, for the sake of prudence, serve those notices in the same fashion as section 57 notices (and in any event, such notices are usually referred to as being pursuant to both section 57 and section 111).

With respect to service of section 92 notices, there is no requirement to serve any person other than the mortgagor.

Section 80 notices need to be served on the mortgagor, and on any guarantor. There is no requirement to serve the notice on any other mortgagees or chargees.

No consequences are prescribed by the RPA or the Conveyancing Act for failure by a mortgagee to serve a default notice on a subsequent mortgagee or chargee. Thus failure to serve does not necessarily lead to any right to stop a mortgagee auction by the mortgagor. Failure to serve may be a basis for an injunction to stop the sale if a subsequent mortgagee wished to remedy the default itself, but was denied the opportunity to do so by lack of notice of the default.

In any event, an allegation of failure to serve a default notice will not necessarily lead to the granting of an injunction to stop a sale. In *Dalton v Latrobe Capital and Mortgage Corporation Ltd*²⁶ a mortgagor applied to the Supreme Court of Victoria for an injunction to stop a proposed mortgagee auction on the basis that the statutory default notice had not been served, although this was disputed by the mortgagee. Habersberger J was inclined to accept that service had occurred, but stated that he may nonetheless have granted the application if it were not for the fact that the mortgagor would have a cause of action in damages against the mortgagee. Thus the availability of an alternative remedy in damages was found to be an important factor in the balance of convenience, the weighing of which resulted in the injunction being refused.

If a corporate mortgagor is deregistered, it ceases to exist, and all its property immediately vests in ASIC (see section 601AD of the Corporations Act). This means that service of notices on deregistered companies is ineffective.

If, however, the company is subsequently reinstated, section 601AH provides that the company is deemed always to have been in existence as if the deregistration had never occurred. This has the effect of retrospectively validating any act during the deregistration period that would otherwise have been ineffective due to the company's non-existence, except to the extent the court orders otherwise: see eg *Video*

²⁶ [2004] VSC 318, BC200405499

*Excellence Pty Ltd v Cincotta*²⁷. Thus if a default notice was served on a company whilst deregistered, the notice would be invalid at the time, but subsequent reinstatement would then retrospectively validate the service, causing it to be effective from the date of service (not merely the date of reinstatement).

Creditors of a deregistered company may move for reinstatement of the debtor company to facilitate action against it, and this is probably the best course for a mortgagee in the case of a deregistered mortgagor.

Service of a default notice when a mortgagor is deregistered could be effected upon ASIC as the new owner of the property, but if that was done reinstatement of the mortgagor company would then invalidate that service (given the deemed continued existence of the company) unless the court reinstating the company made an order validating that service.

8. Consequences of a failure to give proper notice

Failure to serve a proper section 57/111 notice (in a case where service of such notice has not been effectively dispensed with) means that the mortgagee cannot sell the security and cannot invoke any acceleration clause in the mortgage. The failure has no impact on the mortgagee's ability to take possession of the land, absent any terms of the mortgage imposing a notice requirement for possession - see *Long Leys Co Pty Ltd v Silkdale Pty Ltd*²⁸.

In a case where a mortgagee is suing for a money judgment for principal accelerated by reason of a default, the notice needs to be served more than one month prior to the commencement of proceedings so that the benefit of the acceleration clause can be pleaded, as proceedings are defective if their cause of action is not complete at the date of commencement, even if the cause of action becomes complete at a later date: *Baldry v Jackson*²⁹. It is possible, however, to cure such a defect by later amending the Statement of Claim after a later-served default notice expires to plead that expiry, and the claim is then treated as having been made at the date of amendment (see Civil Procedure Act section 64), although prior to such an amendment the proceedings are liable to be struck out as being improperly commenced.

Failure to serve a section 92 notice means that "the mortgagee shall not be entitled to take proceedings to compel payment of the [outstanding principal] sum, or for foreclosure, or to enter into possession, or to exercise any power of sale" with respect to the security. As noted above, this notice should be served and expire prior to commencement of proceedings.

Failure to serve a section 80 notice means that the mortgagee "must not begin enforcement proceedings against a mortgagor to recover payment of money due or take possession of, sell, appoint a receiver for or foreclose in relation to property subject to a mortgage".

²⁷ (1998) 44 NSWLR 742

²⁸ (1991) 5 BPR 11,512

²⁹ [1976] 2 NSWLR 415

In the case of a bona fide mortgagee sale (at least as far as the purchaser was concerned) to a third party for value, the doctrine of indefeasibility of title arising out of RPA section 42 would prevent the bona fide purchaser from being deprived of title to the land after the transfer to the purchaser had been registered. Even if fraud had occurred on the part of the mortgagee, this would not be fraud by the bona fide purchaser, nor would the mortgagor have any personal equity against the innocent purchaser so as to avoid indefeasibility by relying on a personal right.

If a mortgagor was not served with a statutory default notice to which he was entitled, the mortgagee would be liable to the mortgagor for damages for breach of the express or implied terms of the mortgage to serve notices in accordance with the relevant legislation. The quantum of damages depends on the difference between the mortgagor's position had he been served with the notice and the actual position the after the non-service of the notice. If the evidence is that the mortgagor would not have rectified the default even if he had received the notice, then the mortgagor's damages would be purely nominal as no actual loss has occurred. If the evidence showed the mortgagor would have rectified the default within the notice period, then the mortgagor would be able to recover his financial loss resulting from the wrongful sale. This would include not only the additional penalty interest and mortgagees' costs that the mortgagor had been forced to bear, but also any loss resulting from the difference between the sale price at mortgagee sale and the market value of the security sold in happier circumstances. The mortgagor might also have suffered consequential losses, such as removal and accommodation expenses occasioned by the need to vacate the security and live elsewhere. The wrongful sale might also have a flow-on effect by causing the mortgagor to fall into default with other lenders and thus suffer further financial loss which may be recoverable as damages.

Although the Registrar-General was once obliged by the Real Property Act to satisfy himself by way of statutory declaration that default had occurred under a mortgage before registering a transfer by a mortgagee in the nature of a sale, section 59 of that Act no longer contains such an obligation (it was removed by an amendment to the Act in 1930). Nevertheless Registrar-General still has a general duty not to register instruments when there is some reason for him to believe that the transaction giving rise to the instrument is invalid (see *Re Douglas*³⁰). Thus although the Registrar-General will not normally require proof of service of a default notice prior to registration of the mortgagee's transfer, there may arise some cases in which the Registrar-General could properly require proof of such service.

9. Time under notice

RPA section 57(3)(d) requires a section 57 notice to notify that "unless the requirements of the notice are complied with within one month after service of the notice" power of sale may be exercised. Section 111(3)(d) of the Conveyancing Act contains identical words. Time thus runs from the date of service, and notices should state this so that there can be no argument raised that a period of time less than the statutory 1 month period is being allowed because the date stated in the notice is a date prior to the date of service.

³⁰ (1928 29 SR (NSW) 48

Subsections (1)(a) and (2)(a) of section 80 of the Consumer Credit Code refer to the provision of a 30 day period “from the date of the notice”. Taken on its own, this could be interpreted as being the date of drafting of the notice. However, given the fact that the equivalent sections of the RPA and Conveyancing Act require the period to run from service, and given the fact that having time run from the date stated in the notice would mean that the Code could be effectively circumvented by a mortgagee only serving a notice just as the 30 day period was expiring, section 80 should be construed as referring to a 30 day period from service of the notice.

The only provision which relates to a presumed date of service is section 170(1A) of the Conveyancing Act, which provides:

In the case of service by delivery to the facilities of a document exchange, the notice is, unless the contrary is proved, to be taken to have been served on the second business day following the day of delivery of the notice to those facilities.

In relation to notices sent by post, section 160(1) of the Evidence Act raises a presumption in the following terms:

It is presumed (unless evidence sufficient to raise doubt about the presumption is adduced) that a postal article sent by prepaid post addressed to a person at a specified address in Australia or in an external Territory was received at that address on the fourth working day after having been posted.

It should be noted that the above provisions raise no more than rebuttable presumptions. Thus if the mortgagor leads evidence that a notice took seven business days to be delivered, the mortgagee will not be able to rely on the statutory presumptions.

10. Non-monetary defaults

Section 58A of the Real Property Act permits the mortgagee to contract out of compliance with the notice provisions of section 57 in cases of non-monetary defaults, but otherwise voids any attempt to dispense with notice. The section reads as follows:

58A Dispensing with notice or lapse of time

- (1) Any notice or lapse of time prescribed by section 57 (not being notice or lapse of time relating to default in the payment, in accordance with the terms of the mortgage or charge, of any principal, interest, annuity, rent-charge or other money) may, by agreement expressed in the mortgage or charge, be dispensed with, and in such case section 58 shall operate as if no notice or lapse of time were thereby required.
- (2) This section does not apply to covenant charges but applies to mortgages and charges made before or after the commencement of the Real Property (Amendment) Act 1976 and, to the extent to which an agreement dispensing with notice or lapse of time expressed in such a mortgage or charge is not authorised by subsection (1), the agreement has no force or effect.

Thus if a default is non-monetary and the mortgage provides that notice is dispensed with in the case of such defaults, there is no need to serve a section 57 notice.

In *Topfelt Pty Ltd v State Bank of New South Wales Ltd*³¹, the mortgagor induced the mortgagee to enter into the mortgage by representing the intended security land was vacant. The mortgagor later defaulted. The mortgagee served a section 57(2)(b) notice, then entered into a contract for sale of the land. No possession proceedings were commenced prior to contract as the mortgagee believed the land to be vacant, but after exchange of contracts the mortgagee discovered the truth and commenced those proceedings. The mortgagor then challenged the mortgagee's power of sale, and claimed that the 57(2)(b) notice was defective.

At first instance the notice was found to be defective and invalid, but as the mortgagor's misrepresentation was also a "default" under the terms of the mortgage, as such a default was a non-monetary default, and as the need to serve a default notice with respect to a monetary default had been dispensed with in accordance with RPA section 58A by the terms of the mortgage, the mortgagee did not need to serve a section 57(2)(b) notice to obtain a power of sale.

The mortgagor then appealed, its principal argument being that power of sale could only arise from a default that could be remedied, and that as a pre-contractual misrepresentation could not be remedied it could not give rise to a power of sale. The mortgagor, in making this argument, relied on the language used in RPA section 57(3), whereby a notice is sent requiring a default to be remedied.

The Court of Appeal rejected the mortgagor's argument, finding that the Real Property Act did not draw a distinction between breaches able and unable to be remedied. The Court found also that it was arguable, citing *Batson v De Carvalho*³², that the breach could have been remedied by evicting the lessee from the security thus causing "the consequences of the breach by misrepresentations" to be remedied. The appeal was thus dismissed.

In *Bevham Investments Pty Ltd v Beloot Pty Ltd*³³, the High Court determined that the failure of the mortgagor to pay rates and taxes as they fell due was, under the mortgage the Court had before it, a monetary breach, and therefore a section 57(2)(b) notice had to be given before power of sale would accrue to the mortgagee.

In *Commonwealth Bank of Australia v Tugvale Pty Ltd*³⁴, James J had before him a case involving the failure of a mortgagor to keep buildings on the security insured, which failure was a breach of the mortgage. His Honour distinguished *Bevham* and instead followed an earlier Court of Appeal decision, being *Morrisey v Bright*³⁵. His Honour found that a covenant to insure was not a covenant "which is in terms a covenant to pay monies" (p 59,932). By this expression his Honour presumably meant that although effecting insurance almost inevitably involves the payment of money by

³¹ (1993) NSW Conv R 55-676

³² (1948) 48 SR (NSW) 417

³³ (1982) 149 CLR 494

³⁴ [1993] NSW ConvR 59,928

³⁵ [1978] 2 NSWLR 1

the mortgagor, the obligation as stated under the mortgage was not expressly to pay money but rather to effect insurance.

The distinction between covenants to pay money and non-monetary covenants seems to be a very narrow one. Although it has been said that as a general rule, flowing from *Tugvale*, failure to insure is a non-monetary breach, one could readily imagine a mortgage that required the mortgagor to pay all insurance premiums being construed as a case of a monetary breach, following *Bevham*. In the circumstances, the nature of the breach would depend upon the words of the mortgage in question in each case.

D. Compliance with notices by the mortgagor

RPA section 57(4) provides:

Where a notice is served under subsection (2) (b) and the requirements of the notice are complied with within the time applicable to the notice under subsection (3) (d), the default to which the notice relates shall be deemed not to have occurred.

Section 111(4) of the Conveyancing Act is in identical terms.

The subsections do not limit the deeming provision in any way, and thus if the default is rectified within the period specified by a section 111 or section 57 notice, then presumably the default is deemed for all purposes not to have occurred at all. That would mean that if proceedings had been commenced by the mortgagee in reliance upon that same default, they would need to be discontinued as the default would now be deemed not to have happened.

There is no equivalent provision with respect to section 92 of the Conveyancing Act of section 80 of the Code. Payment under a section 92 notice should have the effect of discharging the mortgage. Payment under a section 80 notice means simply that the mortgagee cannot rely on that notice to ground any form of enforcement action.

RPA section 57(5) prevents a mortgagee taking advantage of an acceleration clause until a notice under that section has been issued and expired (assuming issue of the notice has not been effectively dispensed with under section 58A). Section 111(5) of the Conveyancing Act is in identical terms.

In the Court of Appeal decision of *Turnbull v National Mutual Royal Bank Ltd*³⁶, it was found that section 57(5) of the Real Property Act's restriction on the effect of a "covenant, agreement or condition" accelerating repayment of principal was restricted to terms of the mortgage itself, and did not extend to other agreements between the mortgagor and mortgagee. Rolfe J later applied *Turnbull* in *Natwest Markets Australia Ltd v Mannix*³⁷.

It follows that if the mortgagee and mortgagor enter into a separate agreement, such as a Loan Agreement that does not form part of the mortgage, whereby the outstanding principal accelerates immediately upon default without the need for any

³⁶ (1991) 5 BPR 11,887

³⁷ (1995) 7 BPR 14,668

notice, then this agreement will be effective to accelerate the principal notwithstanding RPA section 57(5). To ensure that the Loan Agreement is considered a document separate from the mortgage, there should be no incorporation of the Loan Agreement into the mortgage by reference (for example by a clause such as “This mortgage is subject to the terms of the Loan Agreement, and in the event of any inconsistency the terms of the Loan Agreement shall apply”, as such a clause effectively inserts the terms of the Loan Agreement into the mortgage).

For mortgages under the UCCC, the above device is not available, as the definition of “acceleration clause” in section 84 of the Code includes not only such clauses in a mortgage but also such clauses in any credit contract.

In *Batson v De Carvalho*³⁸, Sugerman J considers at length what “remedying” a breach means in the context of a default notice when the breach in question is a negative covenant (ie a requirement that the mortgagor is not to do something which the mortgagor then breaches by doing that thing). At p 427 his Honour notes:

To “remedy” a breach is not to perform the impossible task of wiping it out - of producing the same condition of affairs as if the breach had never occurred. It is to set things right for the future, and that may be done even though they have for some period not been right, and even though that may have caused some damage... A breach may be remedied, I think, even though the time for doing the thing under the covenant may have passed, or the order of events stipulated for in the covenant can no longer be observed...

Batson was a leasing case, and the default was the tenant’s parting of possession with the leased premises in breach of the lease. The judge found that such a breach was capable of remedy by the tenant retaking possession and procuring the surrender of any sublease that had been granted.

It follows from *Batson* that if the breach of a second mortgage takes place by virtue of the mortgagor being in breach of the first mortgage (the second mortgage containing a clause to the effect that a breach of and prior mortgages is breach of the second mortgage), that the mortgagor can remedy the breach of the second mortgage by remedying the breach of the first mortgage. To remedy a breach of the first mortgage by failure to repay principal under the first mortgage by the due date, the mortgagor could either belatedly repay the principal or cause the first mortgage to be varied such that the failure to repay was no longer a breach (for example, by an extension of the term of the loan).

E. Duties imposed in the exercise of the power of sale

1. The standard of care under the common law

A mortgagee’s duty in exercising power of sale has its origins in equity. Although the mortgagee is not a trustee of the power of sale for the mortgagor (see *Belton v Bass, Ratcliffe and Gretton Ltd*³⁹), the mortgagee is in a form of fiduciary relationship with the mortgagor and thus must exercise the power in a bona fide fashion. However,

³⁸ (1948) 48 SR (NSW) 417

³⁹ [1922] 2 Ch 449

obligations on a mortgagee are less than those imposed on many fiduciaries, and a body of precedent exists specific to the extent of a mortgagee's duty.

Apart from imposing default notice regimes as a precondition to sale, neither the Real Property Act nor the Conveyancing Act regulate to any significant degree a mortgagee's sale. The UCCC also refrains from imposing duties on a mortgagee with regard to the actual sale process.

By contrast section 420A(1) of the 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.

There is uncertainty as to whether a mortgagee can be considered a “controller” for the purposes of this section, but if it is a controller, the section imposes a statutory duty on a mortgagee when the mortgagor is a corporation.

A mortgage may impose additional obligations on a mortgagee with regard to the sale of the security over any above those arising at general law or by statute, but such additional requirements are uncommon as normally mortgages are drafted by mortgagees so as to limit the rights of mortgagors as much as possible, rather than to add to those rights.

In *Pendlebury v Colonial Mutual Life Assurance Society Ltd*⁴⁰ the High Court heard an appeal from the Supreme Court of Victoria. Colonial Mutual was a mortgagee under the Victorian Torrens System legislation that exercised its power of sale over land. Mr Pendlebury was the mortgagor of that land, and he sued Colonial alleging that the mortgagee had breached its duty in relation to properly conducting the sale by completely disregarding Mr. Pendlebury's interests, and claimed damages or, in the alternative, an account of the sum by which the sale price was diminished by the mortgagee's acts.

The sale of the land was arranged by one of the mortgagee's employees, a Mr. Gill. Mr Gill was not actually authorised by the mortgagee to effect this sale, although it later ratified his actions. There was evidence that the land was worth £2,000, but was sold for the sum of £720. The amount at the time owing under the mortgage, including interest and costs and anticipated auctioneer's commission, was £714. The auctioneer's commission was estimated in advance (and recorded on a slip of paper, which was tendered in evidence) at a figure that would correspond to the commission payable if the property sold for £714, which was fixed as the reserve price.

⁴⁰ (1912) 13 CLR 676

The land in question was 640 acres in Victoria's remote "Mallee Country". It was cleared and had access to water, had good soil, was suitable for cereal cultivation and grazing, had 250 acres already sown with wheat and was divided into paddocks. It was first advertised by Mr. Gill in the *Argus*, a Melbourne newspaper, on 26 May 1910, and there were three further advertisements in that newspaper and three in the *Age*, another Melbourne daily paper. Both newspapers circulated all over Victoria. There was no local newspaper advertising, despite the evidence showing such advertising being usual at the time. There were no notices posted locally, and there was evidence from a neighbour he did not realise the property was up for sale. The mortgagor was not informed of the sale.

The advertisements referred to the allotment number of the land and its folio identifier, but did not state its address or location save as to note that "This property is about seven miles from Curyo Railway Station". The advertisements did not refer to the quality of the soil, the fact that the land was cleared, the existence of the wheat crop, or the subdivision into paddocks. The auctioneer responsible for the sale had prepared the advertisement. He was cross-examined and explained that although he would normally inform purchasers of these matters in an advertisement on behalf of an owner of land, it was not his practice to do so with a mortgagee sale. There was evidence led that mortgagees in Melbourne generally observed similar standards of advertising as Colonial Mutual.

The auction date was 14 June 1910. Before the auction the eventual purchaser, Mr. Lindsay, was told by Mr. Gill of the reserve price, although there was no secret of the reserve at the auction itself. One vendor bid of £714 was made (the reserve) and then Mr. Lindsay made the successful bid of £720. Mr. Lindsay, however, had only 4s. to his name so could not even pay the deposit for the purchase, but Mr. Gill and the auctioneer helped him by accepting a worthless cheque for the moment, recommending a solicitor to him with connections to the mortgagee, and then granting him an extension of time. Mr. Lindsay took advantage of this extension to resell the property in July for between £1,800 and £1,900.

Although it was noted that "there were some circumstances of suspicion", the allegation of collusion between Mr. Gill and Mr. Lindsay was not established. However, as Griffith CJ stated, a "quite overwhelming" case was found that the mortgagee had conducted the sale without regard to the mortgagor's interests, and the other two judges concurred with this finding. A declaration was made with respect to the "wilful default" of the mortgagee, and judgment was given for the mortgagor against the mortgagee for the difference between £714 and the price that would have been obtained without wilful default (which price was to be determined by subsequent enquiry). The mortgagee was also ordered to pay the mortgagor's costs.

Of the three judgments in *Pendlebury*, only that of Isaacs J is much concerned with analysing the law pertaining to a mortgagee's duty when exercising power of sale, with the other judges more preoccupied with the facts. His Honour's citations and analysis was along the following lines:

1. *Kennedy v De Trafford* [1896] 1 Ch 762 at 772 was cited as follows with respect to the mortgagee's duty:

It is not right, or proper, or legal, for him, either fraudulently, or wilfully, or recklessly, to sacrifice the property of the mortgagor.

2. *Kennedy v De Trafford* [1897] AC 180 at 192:

If a mortgagee selling under a power of sale... takes pains to comply with the provisions of that power and acts in good faith, I do not think his conduct in regard to that sale can be impeached.

3. “Recklessness” is not mere negligence or carelessness.

4. The bona fides of the mortgagee is the key, in that (p 701):

If he bona fide endeavours to do so, if he takes the best steps to that end, which he honestly believes will secure it, and the circumstances warrant, then he has acted in good faith and cannot be called to account however disastrous the outcome may be.

5. Although a mortgagee is not generally required to delay sale or to incur an additional outlay merely to assist the mortgagor, if the delay or outlay is “in the circumstances reasonable and apparently necessary and prudent to conserve the mortgagor’s interest, and to prevent his residual property being sacrificed” and if it is “manifestly safe”, the mortgagee is not justified in refusing to make that additional outlay or incur the delay, and if it fails to do so will be considered reckless: pp 701-2.

6. In the present case the mortgagee acted recklessly because it “sold the mortgagor’s land without the smallest regard for his interests”, with the mortgagor’s interest being sacrificed “though a comparatively small effort was necessary to prevent the disaster” (pp 702-3).

A line of English decisions, including *McHugh v Union Bank of Canada*⁴¹ (a Privy Council appeal from the Supreme Court of Canada), *Cuckmere Brick Co Ltd v Mutual Finance Ltd*⁴², and *Standard Chartered Bank Ltd v Walker*⁴³ suggested that the mortgagee’s duty when selling the security was not merely to act in good faith, but that there was also a requirement to take “reasonable care”. Although reference to “reasonable care” suggests that the mortgagor may sue the mortgagee in negligence, the Privy Council in *China and South Sea Bank Pty Ltd v Tan*⁴⁴ found to the contrary, deciding that the duty of the mortgagee exercising power of sale stood was different to the duty of care in a negligence action.

Although representing the law in England and New Zealand, the above line of cases have not been followed in New South Wales, where the “good faith” test in *Pendlebury* continues to apply: see *State Bank of NSW v Kit Cheng Chia*⁴⁵.

⁴¹ [1913] AC 299

⁴² [1971] Ch 949

⁴³ [1982] 1 WLR 1410

⁴⁴ [1989] 3 All ER 839

⁴⁵ [2000] NSWSC 552

2. The standard of care under the Corporations Act

S 420A (1) of the Corporations Act provides as follows:

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.

There is uncertainty, however, whether a “controller” of property under the Corporations Act includes a mortgagee exercising power of sale. Section 9 includes the following definitions:

"controller", in relation to property of a corporation, means:

- a) a receiver, or receiver and manager, of that property; or
- b) anyone else who (whether or not as agent for the corporation) is in possession, or has control, of that property for the purpose of enforcing a charge.

"charge" means a charge created in any way and includes a mortgage and an agreement to give or execute a charge or mortgage, whether on demand or otherwise

As a “charge” is defined to include a mortgage, and a mortgagee is a person who enters into possession of property of the mortgagor corporation for the purpose of enforcing its charge, the mortgagee is arguably a “controller”. However Croft and Johannsson in *The Mortgagee’s Power of Sale*, 2nd Edition argue to the contrary, suggesting that it is generally thought that a person is not a controller unless “that person has control and management of the whole property and undertaking of the corporation”.

Campbell J in *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd*⁴⁶ found that there had been a breach by a first mortgagee exercising power of sale of the mortgagee’s statutory duty under section 420A of the Corporations Act. In doing so, however, his Honour noted that the first mortgagee had admitted it was a “controller” within the meaning of that section and so it was unnecessary to decide that question. The authority is thus of little value in determining whether section 420A is applicable to mortgagee sales.

Without any authority on point, the matter must be considered as presently unresolved. If it be the case that section 420A applies to a mortgagee exercising power of sale, it would appear that mere negligence in failing to achieve the best price obtainable would be a breach of statutory duty by the mortgagee if the mortgagor was

⁴⁶ (2002) 10 BPR 19,565

a corporation, whilst the mortgagee would not be in breach of its general law obligations.

3. Unconscionability

Unconscionability on the part of a mortgagee in selling the security has held to be a type of “wilful default” that would cause a mortgagee to fail the “good faith” test in *Pendlebury* (see *Hawkesbury Valley Development Pty Ltd v Custom Credit Corporation Ltd*⁴⁷) However unconscionability of this type is said to occur only in the case of a very serious departure from reasonable standards, and thus cannot be seen as an attempt to introduce the English test of “reasonable care” through the device of unconscionability.

F. Conduct of the Power of Sale

1. Auction, tender or private treaty?

Section 58 (1) of the Real Property Act states that a mortgagee may sell the security

either altogether or in lots by public auction or by private contract, or both such modes of sale, and subject to such conditions as the mortgagee... may think fit

Section 109 (1)(a) of the Conveyancing Act is in similar terms.

Generally speaking, a mortgagee may sell a security property in any fashion it sees fit, provided that mortgagee is making a bona fide attempt to realise the best price reasonably possible without undue delay or expense (in accordance with the *Pendlebury* test). There is no set way that a mortgagee must sell a security property, with no method free of the possibility of criticism.

In cases involving equitable mortgages, the mortgagee has no power of sale of the legal estate, but must instead either sell on behalf of the mortgagor under power of attorney, or alternatively pursuant to orders for judicial sale. In the former case the mortgagee can sell in any fashion the mortgagee desires (absent some restriction in the mortgage), just as any proprietor of land may do. In the case of judicial sale, the mortgagee must sell on whatever terms the court may direct. The usual form of orders in such matters allows either public auction or private treaty.

The mortgagee can be called to account whenever the mortgagee has failed to act in good faith to secure the best price reasonably available. In the case of a private treaty offer being made prior to a planned auction being held, the mortgagee must act in good faith in deciding whether the best price will be achieved by selling to the private offerer or proceeding with the auction.

In *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd*⁴⁸, the first mortgagee received an offer prior to auction of \$9 million, and another offer of \$9.2 million with vendor finance. The first mortgagee refused these offers and proceeded to auction the property. The reserve was initially set at \$9.2 million, but the reserve

⁴⁷ (1995) NSW Conv R 55-731

⁴⁸ (2002) 10 BPR 19,565

was lowered mid-auction to \$6.6 million. The security was then sold at auction for \$6.6 million to a group of companies associated with the former bid of \$9 million. As a result, the third mortgagee was not able to recover any part of its debt and sued the first mortgagee for breach of its general law duty and its breach of section 420A of the Corporations Act.

The suit was successful. Campbell J found that the pre-auction offers suggested that the security had a higher value than \$6.6 million. The auction was held in the absence of the bidder for \$9.2 million in circumstances where, by arranging a pre-auction meeting with that bidder a short time before the auction at a location remote from the auction, the first mortgagee effectively kept the bidder away from the auction. At that meeting the first mortgagee had refused to contract with the bidder because the third mortgagee had declined to withdraw previously-commenced proceedings against the first mortgagee. In the circumstances, Campbell J found that the sale had not been conducted in good faith, and was thus a breach of the first mortgagee's general law duty. His Honour also found a breach of section 420A of the Corporations Law.

2. Auctions

There is no requirement for a mortgagee to use a licensed auctioneer to conduct an auction. If a licensed auctioneer is not used, however, and the property is passed in at auction, no application can be made under RPA section 61 for foreclosure as such an order can only be made if the unsuccessful auction was conducted by a licensed auctioneer. The failure to use a licensed auctioneer may also be taken as evidence that the mortgagee is not acting bona fide to obtain the best price.

Care should be taken to ensure that the auction is properly advertised. This includes not just the fact of the auction but also the attributes of the property. The marketing spend is not the sole factor a court will look at, also relevant will be whether the property was advertised in the appropriate publications. A mortgagee who sells the security at auction without any appropriate advertising is likely to be held to have breached its duty of good faith. However if there was evidence to suggest that notwithstanding the inappropriate advertising the mortgagee was successful in obtaining the best price possible no cause of action against the mortgagee would be sustainable.

The disclosure of the reserve price at an auction may be a breach of the mortgagee's duty, as it may indicate (as in *Pendlebury*) the intent of the mortgagee to sell merely at a reserve price fixed at the amount of the debt due to the mortgagee rather than to endeavour to obtain the best price available. As with every aspect of a mortgagee sale, however, one must look to the circumstances of the case to see whether the duty of good faith has been breached on the special facts of the given case.

The mortgagee can never be completely safe in adopting any mode of sale of a property. If, however, a mortgagee properly advertises an auction, ensures that the auction is properly run, does not reject in bad faith private offers prior to auction that turn out to be in excess of the ultimate sale price, and then accepts the highest bid at auction, it is most likely that the mortgagee will be found to have acted in good faith.

3. Private treaty

There is no requirement for an auction to be attempted prior to effecting a private sale, and indeed in some cases a private sale offer may be so lucrative as to require a mortgagee acting in good faith to accept it. That said, there is merit in the general strategy of attempting to auction a property before selling it privately. In such circumstances it is harder for a mortgagor to allege that a private sale by a mortgagee is a sacrifice of the mortgagor's interests if a properly advertised and conducted auction has already failed to sell the property.

In *Colin D Young Pty Ltd v Commercial & General Acceptance Ltd*⁴⁹ the mortgagor was an experienced real estate agent who had unsuccessfully attempted to sell the security for one year prior to the mortgagee's sale by private treaty. In the circumstances the mortgagee was found not to be in breach of its duty when it sold the security by private treaty without attempting an auction, as the mortgagor's prior failed attempts at sale suggested in that case that there were no other potential buyers available.

There is no set rule as to how a property must be sold. Arguably a property could be sold without advertising. The proper mode of sale depends on the circumstances of the case. If a mortgagee receives a highly lucrative private offer to purchase the security in some circumstances it would be reasonable to take that offer rather than risk losing it by seeking further potential purchasers. In other circumstances the failure of a mortgagee to advertise a property may be seen as evidence of bad faith, particularly if the price at which the security is sold is below the expected market value of the land.

4. Setting a reserve / deciding on a private treaty sale price

Failure to obtain a valuation before setting a reserve or agreeing to a private sale is likely to be considered as evidence of recklessness on the part of a mortgagee exercising power of sale, but as always the circumstances of the particular case must be taken into account. If there is clear evidence of the expected sale price from comparable sales, recent valuations etc it may not be necessary to obtain an up-to-date valuation.

Mortgagees are not constrained to set a reserve at the same level as the valuation. Whether setting a reserve for less than the valuation is bad faith will depend on the circumstances. For example, a mortgagee who sets the reserve at the value of the debt owed to the mortgagee even though that amount is greatly less than the valuation figure is likely to be seen as acting in bad faith, whilst a mortgagee who genuinely believes that the valuation is inflated as compared to the likely price to be obtained at an auction following a forced sale may significantly reduce the reserve below the valuation figure and still be found to be acting in good faith.

5. Obtaining vacant possession

The mortgagee must act in good faith in an attempt to obtain the best price. In most cases this requires that owner occupiers be ejected prior to sale. In relation to some properties (such as commercial premises), continued occupation by a good tenant may

⁴⁹ (1982) NSW ConvR 55-097

enhance the value of the land, and in these circumstances good faith on the part of the mortgagee may require the tenant to be left in occupation.

6. Development sites

As noted previously, Isaacs J in *Pendlebury* said at pp 701-2 that a mortgagee is not generally required to delay sale or to incur an additional outlay merely to assist the mortgagor, but if the delay or outlay is “in the circumstances reasonable and apparently necessary and prudent to conserve the mortgagor’s interest, and to prevent his residual property being sacrificed” and if it is “manifestly safe”, the mortgagee is not justified in refusing to make that additional outlay or incur the delay, and if it fails to do so will be considered reckless.

Thus if completing a development is apparently required to avoid sacrificing the security at sale and if it is “manifestly safe” for the mortgagee to complete the development itself, the mortgagee may be considered reckless and in breach of its duty if it does not complete the development, notwithstanding the fact that the mortgagee must incur some additional expense and delay. The question of safety is, however, important, for his Honour stressed at p 702 that:

It must, however, be safe; if it is not, the mortgagee would be taking risks for the benefit of the mortgagor which he is not called upon to do.

Thus if a mortgagee is assured of being able to sell the developed premises for sufficient money to cover not only the original mortgage debt but also the costs of the development and the mortgagee’s additional default interest during the period of delay, then the mortgagee should undertake the development if sale of the security without the development being complete would lead to a sacrifice of the interests of the mortgagor and/or a subsequent mortgagee.

Any aspect of the property (such as DA approval) which is likely to increase the price a purchaser will pay should be advertised. If the mortgagee fails to advertise such a matter, it may be seen as a breach of the mortgagee’s duty through showing a reckless disregard for the sale price achieved, or it may instead be classed as mere negligence: see *Cuckmere Brick Co Ltd v Mutual Finance Ltd*⁵⁰.

7. Advertising

In *Cuckmere Brick Co Ltd v Mutual Finance Ltd*⁵¹, a case before the English Court of Appeal, the security property had the benefit of planning permission for 100 flats. The mortgagee, when advertising the sale, made no mention of this planning permission. The sale price achieved at auction was £44,000, but there was evidence that if this had been advertised the land would have been likely to sell for approximately £65,000. It was found that the mortgagee in selling the property had acted in good faith, as the failure to advertise planning permission was not caused by the mortgagee acting recklessly, but rather was a failure to take due care.

In *Cuckmere*, a mortgagee was said to owe duties of both good faith and a duty to take due care, and thus the mortgagee was found liable to account to the mortgagor

⁵⁰ [1971] Ch 949

⁵¹ [1971] Ch 949

because of the mortgagee's negligence. Australian courts have not followed *Cuckmere* in imposing a duty to take reasonable care. An Australian court would, presumably, have found for the mortgagee given the same finding of facts.

In the event that the highest bid at an auction of the security fails is not high enough to pay out the mortgagee's mortgage and thus no sale is effected, the mortgagee can apply to the Registrar-General under section 61 of the Real Property Act for foreclosure of the security. If such an application is made the Registrar-General is not obliged to issue the foreclosure order. Section 62 (1)(b) permits him to instead require the mortgagee to offer the land for sale again "in accordance with the directions of the Registrar-General". Thus if a mortgagee anticipates prior to an attempted auction that the property will be passed-in and that a foreclosure application will then be made, it makes good sense for the mortgagee to have that auction conducted in a fashion satisfactory to the Registrar-General so that the Registrar-General is unlikely to order a further sale.

Baalman & Wells' *Land Title Office Practice*, which is a good guide to the actual practice adopted by the Registrar-General, notes at 230.100 a series of matters should be attended to in advertising a security property for sale, including the following:

1. The sale should be advertised in a newspaper circulating in the district in which the security is located;
2. The advertisement should enable a potential purchaser to identify the land without the need for a title search;
3. The advertisement should avoid any errors in describing the land, including its area; and
4. There should be a sufficient number of advertisements and sufficient elapsing of time between advertisement and sale, with what is deemed "sufficient" depending on the circumstances of the case.

All of the above matters might be regarded as good practice for a mortgagee in any event, and thus a mortgagee would be well advised to always advertise a mortgagee sale in the above manner rather than only observing these principles when a foreclosure application seems likely.

Whether or not the property should be advertised as a mortgagee sale depends upon what the mortgagee reasonably believes (on the advice the selling agents) is the best means of maximising the sale price of the security. Advertising a sale as a mortgagee sale might be thought to lead to a belief in the potential purchasers that the land will be sold more cheaply, but on the other hand such advertising might attract more potential bidders to the auction and make such persons more ready to bid. The author as a general practice does not advertise the property as being a mortgagee sale.

8. The Agent

Under the common law, the mortgagee has a duty to act in good faith in exercising the power of sale. The power of sale is exercised when the mortgagee enters into an unconditional contract for sale.

The duty to act in good faith requires the mortgagee to act “without fraud and without wilfully or recklessly sacrificing the interests of the mortgagor but stopping short of exposing the mortgagee to liability for mere negligence or carelessness”: *Commercial & General Acceptance Ltd v Nixon*⁵².

A mortgagee will not be able to discharge its duties simply by appointing a reputable agent to conduct the sale. In *Commercial & General Acceptance Ltd v Nixon*, Brennan J at 526 quoted the following passage from *Wolff v Vanderzee*⁵³, wherein the mortgagee was held liable for his auctioneer’s failure to make appropriate enquiries:

In those days the only way to achieve justice between the parties was to say that the mortgagee was liable to the mortgagor for any damage which the latter suffered by the agent’s negligence and to leave the mortgagee to recover such damages, and also any damage which he had suffered himself, from the agent.

Brennan J then stated at 526, in the context of a statutory duty which imposed a higher duty than the duty of good faith:

Where the duty has been formulated in terms similar to section 85(1), it appears that the duty is not discharged by the mortgagee’s appointment of a competent agent, but extends to responsibility for doing what ought reasonably to be done to obtain a proper price or the true market value.

The mortgagee must ensure that the duty to act without fraud, and to act without deliberately or recklessly sacrificing the interests of the mortgagor, is fulfilled, whether or not an agent is appointed.

The mortgagee is liable for the acts or omissions of the agent, except that a mortgagee is not answerable for ‘mere negligence or carelessness in carrying out the sale’: Isaacs J in *Pendlebury v Colonial Mutual Life Assurance Society*⁵⁴, and Cohen J in *Demarco v ANZ Banking Group*⁵⁵.

An agent may be negligent by, for example, failing to convey more lucrative offers to the mortgagee. The mortgagee will not be liable to the mortgagor for selling at a lower price, as a result of the agent’s omission, unless:

1. the mortgagee’s failed to take reasonable steps or obvious precautions to obtain a proper price, and
2. the failure is sufficiently serious to be characterised as unconscionable.

It should be borne in mind that the mortgagee’s duty to take obvious precautions to obtain a proper or fair price, is not equivalent to the common law standard of negligence. It is a lower standard, and simply requires the mortgagee to take reasonable or bona fide steps to ensure that the property is not sacrificed.

⁵² (1982) 152 CLR 491 at 522

⁵³ (1869) 20 LT 353

⁵⁴ (1912) 13 CLR 676 at 700

⁵⁵ (SC(NSW)) Eq Div, 6 November 1998

The mortgagee's duty is to act in good faith in conducting the sale. Accordingly, an agent may be negligent, but such negligence is not sheeted home to the mortgagee unless the mortgagee lacked good faith in conducting the sale.

9. Timing of the power of sale

In *Commonwealth Bank of Australia v Lee*⁵⁶, Wheeler J held that provided the mortgagee does not exercise the power of sale in bad faith or in breach of a contractual duty, a mortgagor does not owe a duty to exercise rights under the mortgage promptly. The mortgagee can sell the property at a time convenient to the mortgagee regardless of the state of the market, provided that in doing so the mortgagee is not:

1. acting in bad faith, or more particularly
2. wilfully or recklessly sacrificing the interests of the mortgagor.

The foundation for the mortgagee's ability to be able to sell the property at a convenient time, subject to the duty to act in good faith, is that the mortgagee has a substantial beneficial interest in the property. The mortgagee is not a trustee of the property, and the power of sale allows the mortgagee to realise the mortgaged debt.

The mortgagee is not obliged to time the sale so as to obtain the 'best price.' The mortgagee is required to act bona fide and to take reasonable care to obtain a proper price, or to seek the best price available in all the circumstances: *Commonwealth Bank of Australia v Lee*⁵⁷. If the mortgagee is absolutely careless whether a fair price is obtained, such conduct is reckless and is capable of being conduct in bad faith: *Pendlebury v Colonial Mutual Life Assurance Society*⁵⁸.

If the mortgagee fails to take reasonable or bona fide steps to ensure that the property is not 'sacrificed', then that may demonstrate a lack of good faith. However, a lack of bona fides will not be established simply because a mortgagee has not sold a security at a time when it might have realised the best price: *Commonwealth Bank of Australia v Lee*⁵⁹.

10. Maintaining and improving the security

In some circumstances a mortgagee is obliged to improve the security even though it involves expense on the mortgagee's part. In *Pendlebury v Colonial Mutual Life Assurance Society Ltd*⁶⁰, Isaacs J discussed the mortgagee's duty to act in good faith, and the expectation that the mortgagee is required to spend money on the mortgaged property if it is necessary to preserve the mortgagor's interest in it. The duty to act in good faith requires the mortgagee to obtain the best possible price so that it can realise the security, without wilfully sacrificing the interests of the mortgagor.

⁵⁶ (1996) 22 ACSR 574 at 578

⁵⁷ at 578

⁵⁸ (1912) 13 CLR 676 at 680

⁵⁹ at 578

⁶⁰ (1912) 13 CLR 676

In the context of that duty, Isaacs J considered that a mortgagee is not expected, as an owner might, to risk considerable outlay to secure an enhanced return on the property. Isaacs J then stated at 701-2:

But if a further outlay is in the circumstances reasonable, and apparently necessary and prudent to conserve the mortgagor's interest, and to prevent his residual property being sacrificed, and if, having regard to what a cautious man would consider the total selling value of the property, it is manifestly safe, the mortgagee is, in my opinion, not justified in refusing to make or incur it merely because he can get enough for himself without it.

His Honour then stressed that it must be safe to incur further expenditure, before a Court would hold that failure to expend amounts to wilful or reckless neglect in preserving the mortgagor's interest in the property.

In *National Australia Bank v Jenkins*⁶¹, the Court cited the principles in *Pendlebury* and found the mortgagee in breach of its duty to take reasonable steps to obtain "the best price for the property, being an aspect of the statutory duty to sell in good faith and having regard to the interests of the mortgagor."

In *National Australia Bank v Jenkins*, the mortgagee in possession of the property failed to take steps to preserve the property (a reception centre), specifically by failing to provide a security service and a caretaker. If such steps were taken, which the Court found were reasonable and 'safe' (in the words of Isaacs J in *Pendlebury*), the property and its value may have been preserved and led to a successful sale at auction. Instead, the property deteriorated and lost value, and the mortgagee's failure to take those reasonable steps failed to preserve the interests of both the mortgagee and the mortgagor.

In light of the decisions in *Pendlebury v Colonial Mutual Life Assurance Society Ltd* and more recently *National Australia Bank v Jenkins*, if

1. a further outlay is in the circumstances reasonable, and necessary and prudent to conserve the mortgagor's interest, and to prevent his residual property being sacrificed, and,
2. having regard to what a cautious man would consider the total selling value of the property, it is manifestly safe,

then the mortgagee has a duty expend money to preserve the security.

If the expenditure is out of all proportion to the value of the secured debt, the mortgagee may not be able to add the cost of enhancement to the mortgage debt: *Southwell v Roberts*⁶².

The considerations for determining the reasonableness of the expenditure, and whether the costs of improvements to a mortgaged property can be added to the mortgage debt, are (as per Dixon J in *Southwell v Roberts*⁶³):

⁶¹ (1999) V Conv R 54-601

⁶² (1940) 63 CLR 581

1. the proportion of the expenditure to the mortgage debt – a mortgagee is not entitled to burden the property with a debt out of all proportion to the sum secured.
2. the effect of the expenditure on the equity of redemption and the mortgagor's ability to redeem
3. the change in the nature of the property as a result of the expenditure – a mortgagee is not entitled to change the property to such an extent that the nature of purpose of the property is radically altered.
4. the expenditure as compared to the enhanced value of the property – the mortgagee cannot load the security with expenditure which is not reflected in the increased value of the property.

11. Obtaining the best price

The duty to act in good faith requires the mortgagee not to wilfully or recklessly sacrifice the mortgagor's interest in the sale of the property. The duty does not require the mortgagee to obtain the highest possible price.

The High Court has said that the duty to take reasonable care to obtain a proper price, the true market value, or the best price available in all of the circumstances, is perhaps a more onerous duty than a duty to act in good faith: *Commercial & General Acceptance Ltd v Nixon*⁶⁴.

There is other authority suggesting that the duty of good faith includes seeking the best price available in all of the circumstances: *Demarco v ANZ Banking Corporation & Anor*⁶⁵. In *National Australia Bank v Jenkins*⁶⁶, the Court cited the principles in *Pendlebury* and found the mortgagee in breach of its duty to take reasonable steps to obtain "the best price for the property, being an aspect of the statutory duty to sell in good faith and having regard to the interests of the mortgagor."

A mortgagee's failure to obtain the true market value does not mean that it has wilfully or recklessly sacrificed the mortgagor's interests or failed to conduct a bona fide sale, which is the essence of the good faith standard in Australia. However, where the mortgagee omits to take obvious precautions to obtain or ensure a fair price, and the mortgagee is absolutely careless whether a fair price was obtained or not, then the mortgagee's conduct is reckless and not in good faith.

The good faith standard in Australia is essentially reflected in *Pendlebury*, wherein both Griffith CJ (at 680) and Barton J (at 695) refer to taking precautions to obtain a fair or proper price. This standard of acting in good faith is not the same as the common law duty of care standard.

In summary, the common law duty of a mortgagee to obtain the best price is not part of the law of NSW, where the applicable standard is the less onerous "good faith" test

⁶³ at 597-9

⁶⁴ (1982) 152 CLR 491 at 522 per Brennan J

⁶⁵ (SC(NSW)) 6 November 1998 Cohen J BC9807681

⁶⁶ (1999) V Conv R 54-601

laid down in *Pendlebury*. Part of satisfying the “good faith” test, however, involves seeking the best price available for the security.

In *Davis v Taylor*⁶⁷, Roper CJ applied the principles in *Pendlebury v Colonial Mutual Life Assurance Society Ltd*⁶⁸, and *Kennedy v De Trafford*⁶⁹. In the latter case, which also applies the good faith standard, the effect of Lord Herscell’s judgment at 185 is that a mortgagee would not be acting in good faith if he or she acts with an intention of dealing unfairly by the mortgagor, or if he or she wilfully and recklessly deals with the property in such a manner that the interests of the mortgagor are sacrificed.

Roper C.J. held that even though the mortgagee in that case

1. sold the property at an undervalue,
2. failed to notify the mortgagor of the sale,
3. failed to advertise the property for sale or for auction the property, and
4. believed she was in a position of absolute owner, and in that respect disregarded any interest that the mortgagor might have had (noting of course that the mortgagor had expressed an attitude prior to the sale that he had no interest in it at all),

the price was obtained as a result of a bona fide exercise of the power of sale. It was further held that the price was not fixed with a reckless or wilful disregard of the mortgagor’s interest. As Roper C.J. stated at 523:

...it was a price which arose naturally from the circumstances and which a reasonably prudent man, even acting on his own interests, might well have been induced to take at the time.

The traditional test (*Farrar v Farrars Ltd*⁷⁰) is that a mortgagee is bound to sell the property fairly and to take reasonable steps to obtain a proper price. A mortgagee is not required to wait for better times before selling. In *Farrar v Farrars Ltd* Chitty J stated:

The mortgagee has a right to obtain payment of his debt... without regard to the then existing condition of the market. He cannot be required to run any risk in postponing the sale, or to speculate for the mortgagor’s benefit.

In *Pendlebury* Barton J referred to the duty of the mortgagee not to wilfully or recklessly sacrifice the property of the mortgagor, and said at 699-701 that “the word ‘recklessly’ cannot include mere negligence or carelessness in carrying out the sale.”

In a similar vein to Chitty J in *Farrar v Farrars*, Barton J held at 701-2 that a mortgagee cannot be answerable to the mortgagor for mere carelessness in realisation of the property.

⁶⁷ (1948) 48 SR (NSW) 514

⁶⁸ (1912) 13 CLR 676

⁶⁹ [1897] AC 180

⁷⁰ (1889) 40 Ch D 395

The mortgagee, when the permitted time arrives, is not bound to wait for his money, merely because the mortgagor might profit by delay.

Further, at 702, Barton stated:

By 'recklessly' then, I understand a disregard of the mortgagor's interest, his property in the possible surplus, in short, not caring whether its fair and proper value was obtained or not, as distinguished from the mere want of care or prudence in the course of honestly trying to conserve it.

In light of the above authorities, the reference by Roper C.J. in *Davis v Taylor* to the 'reasonably prudent man', is based on the traditional test of taking reasonable steps or precautions to obtain a fair or proper price, as opposed to a higher duty of care that leads to a mortgagee being held liable to the mortgagor in negligence. Properly understood, the decision remains good law.

12. Consulting other stakeholders

It is a good practice to consult with the mortgagor and subsequent priority stakeholders. The advantage of this is that the mortgagee's good faith is less likely to be called into question: *Nixon v Commercial & General Acceptance Ltd*⁷¹. This is particularly important where a surplus is anticipated, because it means that the mortgagor has a clear interest in the equity of redemption, and the mortgagee must not wilfully or recklessly sacrifice the mortgagor's interest.

Refraining from consulting with the other stakeholders could be an indication that the mortgagee is acting in bad faith, particularly if there are other acts that suggest that the mortgagee is wilfully or recklessly sacrificing the interests of the other stakeholders. This, however, would only be one small part of a court's consideration. Mere failure to consult does not constitute bad faith if the mortgagee has conducted the sale in a proper manner, but if the sale has been conducted in a dubious manner such failure might add some support to the notion that the sale has been conducted in disregard of the interests of the persons not consulted.

Even though a mortgagee has a duty to act in good faith in exercising its power of sale, and must not wilfully or recklessly sacrifice the mortgagor's interests, a mortgagor will be denied relief if the mortgagor expressly consents to the mortgagee exercising its power in a particular fashion. Further, if the mortgagor impliedly consents to the mortgagee's conduct in exercising the power of sale, or adopts an otherwise improper sale, relief will be denied: *Kock v Kemp*⁷². If a mortgagor is unaware of the mortgagee's conduct in exercising the power of sale, one could not say that the mortgagor impliedly consented to the mode of the exercise of the power.

⁷¹ (SC(Qld)), Connolly J 18 July 1979, unreported

⁷² (1867) 6 SCR (NSW) (L) 107

G. The purchaser

1. Can a mortgagee sell to himself?

There is a settled rule of equity preventing a mortgagee from selling mortgaged property to himself either alone or with others, or to a trustee for himself. However, recently it has been considered and qualified in both Australia and England.

The principal authority for the rule is the English Court of Appeal decision in *Farrar v Farrars Pty Ltd*⁷³ (but see also *Sewell v The Agricultural Bank of Western Australia*⁷⁴ where Lindley LJ observed:

It is perfectly well settled that a mortgagee with a power of sale cannot as against the mortgagor sell to himself...nor to anyone employed by him to conduct the sale... A sale by a person to himself is no sale at all, and a power of sale does not authorise the donee of the power to take the property subject to it at a price fixed by himself, even although such price be the full value of the property. Such a transaction is not an exercise of the power, and the interposition of a trustee, although it gets over the difficulty so far as form is concerned, does not affect the substance of the transaction.

The lack of independent bargaining power present in such a transaction forms the substantive basis for the rule (explained in the decision of Chitty CJ whose decision was upheld on appeal in *Farrar*⁷⁵). A sale of a property found to be in breach of the rule will be voidable in equity for constructive fraud at law (See *Re White Ex Parte Goggs*⁷⁶), or alternately the property will be held in equity to remain subject to the mortgagee's right of redemption (*Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)*⁷⁷).

Lindley LJ was correct in observing the rule was well settled when that case was heard (see *Martinson v Clowes*⁷⁸; *Conroy v Knox*⁷⁹; *Hodson v Deans*⁸⁰). However, it is important to remember that the Court of Appeal held in *Farrar* that the mortgagee had not breached the rule by selling to a company of which it was a shareholder. Indeed the sale by Mr Farrar was not disturbed by the Court because the mortgagee was held to have been "doing the utmost in his power to find a purchaser at the best price that could be got." The Court placed importance on the fact that Mr Farrar, the mortgagee, was not a director of the purchaser and the sale was not made at undervalue.

The *Farrar* rule was discussed with apparent approval by the High Court in *Sewell v The Agricultural Bank of Western Australia*⁸¹. However, even while affirming the prohibition against a related sale by a mortgagee, the High Court in *Sewell* unanimously upheld a sale by a bank to its own district inspector in circumstances

⁷³ (1888) 40 Ch D 395 at 409

⁷⁴ (1930) 44 CLR 104

⁷⁵ (1888) 40 Ch D at 398

⁷⁶ [1866] QSCR 149 at 151

⁷⁷ [1969] 1 NSW 676 at 679-80

⁷⁸ (1882) 21 Ch 857 at 860

⁷⁹ (1901) 11 QLJ 112

⁸⁰ (1903) 2 Ch 647 at 650

⁸¹ (1930) 44 CLR 104

where the bank was found to have first exhausted all reasonable efforts to sell land through public advertising over 18 months. The court said it was entitled to sell the land to its own district inspector if he was not involved in the process of the sale, and where it had taken steps to ensure that the best price for land was obtained will be enough to defeat the rule.

i) The current Australian position

The current position in NSW courts begins with the judgment of Else-Mitchell J in *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)*⁸².

Else-Mitchell J held that a purported sale and transfer of land by a mortgagee (supposedly in the exercise of a power of sale) to a wholly owned subsidiary whose directors were the directors of the parent company, was “not an exercise of the power at all but was, in substance, merely a transfer to the [mortgagee] or its agent”. The relevant passages of *Farrar* were quoted and the land transferred was found to remain subject to the mortgagor’s right of redemption.

In *ANZ Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd*⁸³, the High Court considered the judgment of Lindley LJ in *Farrar* in detail and determined that rather than instituting a rule against a mortgagee selling mortgage property to itself, the English Court of Appeal was merely implementing the general test as to “whether (the sale) was a truly independent bargain” (at 544).

In *Australian and New Zealand Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd & Ors*, the High Court heard an appeal from the Supreme Court of New South Wales. The case involved the sale of a station property near Moss Vale known as “Bangadilly” by public auction in Sydney by the first mortgagee Halco Products Pty Ltd (“Halco”). Halco was a company controlled by a Mr. and Mrs. Hall. The successful bid at the auction was made by Mr. Hall on behalf of Bangadilly Pastoral Co Pty Ltd, itself substantially controlled by Mr. and Mrs. Hall.

The evidence was that the Halls were keen to purchase Bangadilly, and had previously entered into a contract for sale with the mortgagors. This contract for sale failed to proceed, however, despite the Hall’s attempt at obtaining specific performance. On the same day as the specific performance proceedings were to be heard, Halco purchased the first mortgage over Bangadilly by paying out the present first mortgagee in full in the sum of \$280,000 on 18 October 1974. That same day Halco also decided to put the security up for auction, which auction was in due course scheduled for 23 December 1974.

Although Halco decided on 18 October to sell the security, no advertisements appeared until 13 November. The auction date of 23 December was a date that was agreed by the auctioneer in evidence to be a poor date for an auction given its proximity to Christmas. The advertisements placed numbered four in “Country Life”, two in “Land Newspaper”, two in “Stock and Land” (a Melbourne weekly), and only one in the “Sydney Morning Herald”. A hundred brochures were also printed. The total cost of the advertising was \$336.27. None of the advertisements were placed in

⁸² [1969] 1 NSW 676 at 679-80

⁸³ (1978) 19 ALR 519 at 542-543

any local papers, and the one advertisement in the Sydney Morning Herald was not placed until 14 December. Under cross-examination the auctioneer agreed that the level of advertisement was light.

On 15 December 1974, another of the Halls' companies, Halco Roll-Up Doors Pty Ltd, changed its name to Bangadilly Pastoral Co Pty Ltd ("Bangadilly Pastoral") and resolved to bid up to \$265,000 for Bangadilly station at auction. Later, on the morning of the auction, Bangadilly Pastoral resolved that the maximum bid the company would be prepared to make would be raised to \$303,600, and the Halls were present when this resolution was made.

The reserve at the auction was set at \$250,000, being a figure \$30,000 less than what Halco had paid for one mortgage only two months previously. Bangadilly was also subject to a second mortgage to the ANZ Bank, but the Bank was not informed at any time prior to the auction that the security was being sold, or even of the acquisition by Halco of the first mortgage. The only bidders of significance at the auction were Mr Hall and the Halls' accountant, Mr. Pritchard. These two bid the property up to \$265,000, at which point it was sold to Bangadilly Pastoral, on whose behalf Mr Hall had been bidding. On the same day Mr. Hall also had the role of giving instructions to the auctioneer on behalf of Halco.

In consequence of the sale price, the ANZ Bank brought proceedings seeking to set aside the sale of the property by Halco to Bangadilly Pastoral. The proceedings were heard and dismissed by the trial judge, Helsham J, because his Honour found no evidence of a deliberate plan by Halco to sell Bangadilly at an undervalue for the benefit of its associated company. The ANZ Bank appealed this decision.

The High Court unanimously held that the sale should be set aside. In his reasons for judgment, Aickin J stated at p 544 the following:

One of the critical questions here is whether there ever was an independent bargain. The deciding minds were those of Mr. and Mrs. Hall and of no one else. They were the only directors of the mortgagee (Halco Products); they were the only directors of the purchaser Bangadilly Pastoral Co. They fixed the reserve; they, with their agent Pritchard, were the only bidders, and they fixed the maximum price which the purchaser was prepared to pay. As controllers of the vendor, they knew that a prospective purchaser was prepared to pay \$303,000, and as controllers of the purchaser they knew the reserve. In such a situation it seems to me that a purchase at or close to the reserve cannot be an independent bargain.

His Honour found that in the circumstances "the onus lay on the purchaser to prove the bona fides of the sale". In finding that the purchaser had not satisfied this onus, his Honour noted that the sale was not an ordinary mortgagee sale in which the mortgagee seeks to recover principal and interest, but rather right from the time of purchase of the first mortgage there was always in mind the possibility that a company related to Halco would purchase at auction. His Honour also cited the delays in proceeding to sell the property that resulted in a 23 December auction date "likely to have a prejudicial effect on the sale", the delay in advertising in the Sydney Morning Herald, and the failure to inform the ANZ Bank either of the sale or of the acquisition of the first mortgage.

In relation to advertising, Stephen J stated at p 521 that Halco "failed to ensure that those entrusted with arrangements so timed and advertised the holding of the auction as best to attract interest on the part of potential buyers." Jacobs J at p 523 noted "There was no local advertising of the proposed auction sale, virtually no Sydney or Melbourne advertising, and the sale was held in Sydney. The lead time was minimal".

More recently, in both *Re One.Tel Network Holding*⁸⁴ and *Re Actwane Pty Ltd (in liq) (rec and mgr apptd)*⁸⁵ Austin J has questioned whether the *Farrar* rule has "survived into the 21st century" in light of the Privy Council's decision in *Tse Kwong Lam v Wong Chit Sen*⁸⁶ where it was held that:

...there is no hard and fast rule that the mortgagee must not sell to a company in which he is interested. The mortgagee and the company seeking to uphold the transaction must show that the sale was in good faith and that the mortgagee took reasonable precautions to obtain the best price reasonably obtainable at the time.

Citing that decision as evidence of the demise of the *Farrar* rule, Austin J reasons in *One.Tel* that where the technical problems of a mortgagee selling to itself are overcome (say through sale to a trustee or to a company in which the mortgagee has an interest), then it will be a matter to be determined in each case whether there is any "inherent unfairness" in the transaction (see *One.Tel*⁸⁷; see also *Vortex Petroleum Industries Pty Ltd*⁸⁸). He says:

The concern about the inherent unfairness of a mortgagee exercising a power of sale in its own favour, which appears to underlie Lindley LJ's remarks in the *Farrar* case, is simply not in evidence where the transaction in question results from a complex negotiation compromising many other claims.

He distinguishes between the "logical difficulty" of a mortgagee selling to itself, and a case where there is a real basis for suspecting that the market value is not being paid. This would certainly be consistent with the High Court's substantive decision in *Sewell*.

The *Farrar* rule may therefore now be better understood to be an observation as to a mortgagee's general obligation not to "place himself in such a position as to give rise to a conflict of interest and duty" (*Farrar*, supra at 410-411) in the context of the practical problems of selling to and buying from itself and its related parties, remembering that in a case of suspicion, the onus is shifted upon the mortgagees to uphold the sale: see *Hodson v Dean*⁸⁹).

⁸⁴ (2001) 40 ACSR 83 at 96

⁸⁵ (2002) 42 ACSR 307

⁸⁶ [1983] 3 All ER 54

⁸⁷ at 96

⁸⁸ (1989) (unreported) SC(NSW), Hodgson J

⁸⁹ [1903] 2 Ch at 647 at 653

ii) Section 109(1)(a) of the Conveyancing Act 1919

Section 109(1)(a) of the Conveyancing Act 1919 provides that:

- (1) A mortgagee and a chargee shall by virtue of this Act have the following powers to the like extent as if they had been in terms conferred by the instrument creating the mortgage or the covenant under which the charge arose but not further, namely:
 - a) A power to sell or to concur with any other person in selling the mortgaged or charged property ...and to buy in at an auction ... without being answerable for any loss occasioned thereby.

As that power is to be treated as being “conferred by the instrument creating the mortgage”, the mortgagee is in no better position as a result of this statutory provision than if the power to buy in was a contractual term in the mortgage. The power does not in any sense override the mortgagee’s duty of good faith or the logical difficulty with a person purchasing from himself. Thus if the mortgagee seeks to exercise the power to “buy in at auction”, the purchaser must be another entity other than the mortgagee, and the bargain must be a genuine bargain.

iii) When it is the only way to get the best price

An examination of the High Court’s judgment in *Sewell*, which upheld a bank’s sale to its district sales manager when the property had remained unsold for a long time, shows that the efforts taken by the mortgagee to maximise the return on the sale was central to the Court’s willingness to bend the rule it recognised as deriving from *Farrar*. Indeed, in *Farrar*, Lindley LJ had similarly emphasised the hard work of mortgagee to maximise the sale price in justifying the exercise of his discretion. He noted:

... [the mortgagee’s] interest was to get the best price he could, for his security was by no means ample, he was pursuing that interest, and was discharging that interest at the same time, and he had no conflicting interest in the matter.

The judgments of Austin J in *One.Tel* and *Actwane* (see below) reject the application of a hard and fast rule against related mortgagee sales if there is evidence that there is no breach of the obligation to maximise the return on the mortgage property.

iv) Conclusion

A mortgagee cannot literally “sell to himself”, as this is deemed a logical impossibility. In other words, if Mr. John Smith was mortgagee, he could not arrange a sale of the security to himself, Mr. John Smith, as a transaction with the same party on each side is a nonsense. This “logical difficulty” is however cured if the purchaser is a person or entity merely associated with Mr. Smith, such as the mortgagee’s company “John Smith Pty Ltd”. If, however, the purchaser is effectively under the mortgagee’s control, the sale can nonetheless be improper due to lack of any genuine bargain being made given the common control of both parties. Whether or not this difficulty arises in any given case will depend upon the fashion in which the purchase price was arrived at.

2. Can a receiver sell to a mortgagee who appointed him?

The case of a receiver selling to a mortgagee who appointed him was considered in Austin J in *Re Actwane* (Supra at 10). Although finding that the issues arising were appropriate for judicial direction before the sale, his Honour held (applying the Privy Council's decision in *Tse Kwong Lam v Wong Chit Sen* that:

the “logical difficulty” to which I referred in the *One.Tel* case does not arise, because the mortgagee who appointed Mr. Sims as receiver and manager is not the same entity as the purchaser.

The Rule was not seen as sufficient to stop a purchase of land from a receiver or controller to its appointor. However, his Honour was careful to footnote his judgment with the reservation that it was given:

...notwithstanding the principle of mortgage law that the mortgagee cannot exercise a power of sale in favour of itself

The same conclusion was reached by Hodgson J in *Re Vartex Petroleum Industries Pty Ltd*⁹⁰. In *Expo International Pty Ltd (in liq) v Chant*⁹¹ Needham J found that it was only in the case of an abuse of power that a Court will interfere such as:

... for example, a mortgagee recklessly or dishonestly sells mortgaged property at a gross under-value

3. Can a mortgagee sell to a company he is a shareholder in?

In *Farrar* Lindley LJ considered whether the ‘rule’ against a mortgagee selling to itself prevented a solicitor who was one of the mortgagees selling to a company in which he held 10% of the shares of the purchaser company. The Court held that this interest did not prevent the sale, even though a sale to a trustee of the mortgagee was said to be prevented by the rule.

In the *One.Tel* case Austin J discusses this anomaly and notes:

The absolute equitable principle does not apply, in Lindley LJ's view, where the mortgagee exercises the power of sale in favour of a company in which he has a shareholding interest. Such a sale is not, in his Lordship's view, either in form or substance a sale by a person to himself, and “to hold that it is, would be to ignore the principle which lies at the root of the legal idea of the corporate body, and that idea is that the corporate body is distinct from the persons composing it”: at 409–10. Where the mortgagee has an interest in the corporate purchaser, the sale may be open to attack on various grounds relating to fraud or undervalue, and the purchasing company has the burden of proving its validity, but the sale is not invalidated, per se, by the rule which prevents the mortgagee from selling to itself.

He also observes that the Privy Council did not obstruct a sale to a purchaser in the case of *Tse Kwong Lam v Wong Chit Sen*⁹² selling to a company in which the only

⁹⁰ (1989) BC8901834 NSWSC

⁹¹ [1979] 2 NSWLR 820 at 833

shareholders in the purchaser company were the mortgagee, his wife and children. Austin J observed (at 83):

Their Lordships (in *Tse Kwong Lam*) did not apply the strict mortgage principle, but rather the more fact-based proposition, previously enunciated by Lindley LJ, which cast the onus on the purchaser company to justify the transaction. They said (at 1355):

In the view of this Board on authority and on principle there is no hard and fast rule that the mortgagee must not sell to a company in which he is interested. The mortgagee and the company seeking to uphold the transaction must show that the sale was in good faith and that the mortgagee took reasonable precautions to obtain the best price reasonably obtainable at the time.

While the Court in *Bangadilly Pastoral* struck down a sale where the mortgagee company had common shareholders to the purchaser, the court emphasised the particular facts in the case which implied that the sale may not have been at market terms.

4. Can a mortgagee sell to the Real Estate Agent he retained?

There are instances where the courts have struck down sales where the purchaser was the mortgagee's solicitor. In *Parnell v Tyler*⁹³ a sale was voided by the mortgagee's solicitor's clerk bidding at the auction as raising an "improper interference" (at 197). The same principle is accepted as settled law in *Martinson v Clowes*⁹⁴. The reasoning in those cases emphasises the fact that a solicitor is likely to be privy to information that will raise doubt as to the genuineness of the bargain. The same reasoning has been applied to raise doubt as to the validity of a sale to a real estate agent employed by the mortgagee.

In view of the general principles previously set out, however, these cases cannot be seen as an absolute bar against selling to an agent of the mortgagee, but rather as a caution that the mortgagee will have to take pains in such instances to ensure that a genuine bargain is reached notwithstanding the fact that the purchaser is effectively acting on the mortgagee's instructions.

5. Sales to related parties generally

The general obligation of a mortgagee who proposes selling to a related party is the same as that recognised in *Farrar* not to place itself in a situation of conflict of interest or duty.

In the case of *Sewell v Agricultural Bank of Western Australia*, the High Court refers to a duty to "look out for other purchasers" who were not related entities, and suggests that there is less likely to be a breach if the purchaser is not involved in the sale.

⁹² [1983] 1 WLR 1349

⁹³ [1833] LJ 2 Ch 195

⁹⁴ (1882) 21 Ch D 857 at 861

These duties arise from, rather than being in addition to, a mortgagee's general duties to take reasonable precautions to obtain the best price reasonably obtainable at the time, and without any intention of dealing unfairly by his mortgagor. As Lord Herschelle expressed it in *Kennedy v de Trafford*⁹⁵:

...if a mortgagee, in exercising a power of sale, exercises it in good faith, without any intention of dealing unfairly by his mortgagor, it would be difficult indeed, if not impossible, to establish that he had been guilty of any breach of duty towards the mortgagor.

The judgments in *Hogson v Dean*⁹⁶ and *Sewell*⁹⁷ each observe that the obligation on the mortgagee when considering a sale to a related party will be greater where there is a chance that after a sale there will be a balance left after the sale for the mortgagor after the property is sold.

Bangadilly Pastoral demonstrates that when selling to a related entity, a mortgagee will need to take particular pains in properly advertising and conducting the sale, and in ensuring that the purchase price is no less than the true market value, or otherwise the sale is likely to be labelled as a sham, being part of a conspiracy between mortgagee and purchaser to obtain the security at a sub-market price.

6. Can a mortgagee sell to a mortgagor?

There is no breach of duty arising from a mortgagee selling to one of several mortgagors. Nor is there any fiduciary obligation between co-mortgagors which would prevent the purchase. In the judgment of the Court of Appeal (confirmed in the House of Lords) in *Kennedy v de Trafford*⁹⁸, Lindley LJ said:

The mortgagee is entitled to sell to anybody who can buy, provided that he deals fairly and properly in the ordinary way. I see no ground whatever for excluding any mortgagor, if there happen to be several, from buying.

Kay LJ in the same judgment observes, that "...if there be a single mortgagor, he has nothing to do but redeem, and if he pays the principal, interest and costs he redeems." In other words, if the "purchasers" of the security is the mortgagor (of if several mortgors, all those mortgagors), then the "purchase" is really in the nature of a redemption of the security rather than a sale.

The rule in *Otter v Lord Vaux*⁹⁹ holds that a mortgagor cannot set up against his own encumbrancer any other encumbrance created by himself Lord Cranworth LC at 642-643; 1383. The rule extends to a purchase by the mortgagor of the security at a mortgagee sale, in the circumstances that a purchase by a mortgagor of the security from a first mortgagee is similar in nature to a redemption of the mortgage. The rule was upheld in relation to Real Property Act land by the New South Wales Court of Appeal in *Sussman v A G C Advances Ltd*¹⁰⁰.

⁹⁵ [1897] AC 180 at 185

⁹⁶ at 652

⁹⁷ at 110

⁹⁸ [1896] 1 Ch 762 at 770

⁹⁹ (1856) 43 ER 1381

¹⁰⁰ (1995) 37 NSWLR 37

Kirby P observed:

... the rule is based on the equities which arise from a defined contractual relationship. It would be unconscionable for a mortgagor to pay out a first mortgage, and then attempt to rely on this newly bare security to escape from the burden of subsequent mortgages. That is why equity has established the applicable principle to resist such an obviously unconscionable transaction.

See also *R v Registrar of Titles; Ex Parte Watson*¹⁰¹.

Thus although a mortgagor may purchase the security from a mortgagee at a mortgagee sale, the purchase will not, at least in equity, extinguish subsequent mortgages over the land. This was identified by the Court of Appeal in *Sussman* as an exception to indefeasibility of title.

H. The conveyance

1. The sale terms

There is no express statutory power for a mortgagee to sell on terms involving leaving part or all of the sale price unpaid for a period. There is, however, a general law principle that a mortgagee may sell in such a fashion provided that the mortgagee accounts to the mortgagor (and presumably any subsequent mortgagee) for the full amount of the sale price at the time of sale, even though the actual payment of the price is much delayed: see *Belton v Bass, Ratcliffe and Gretton Ltd*¹⁰². This is because the mortgagee takes the risk of non-payment by the purchaser and there is no prejudice to the mortgagor or any subsequent mortgagee through delay or risk of ultimate non-payment.

A mortgagee may not, on the other hand, enter into a contract for sale with a term delaying the completion date for a number of years, as this could operate to the detriment of the other interested parties: *Chapman v Wade*¹⁰³.

2. The power to transfer

Section 59 of the Real Property Act reads:

The Registrar-General shall, for the purpose of a sale authorised by section 58, register a transfer executed by a mortgagee, chargee or covenant chargee in the approved form and, upon that registration, the estate or interest of the mortgagor, charger or covenant charger in the land comprised in the transfer shall pass to and be vested in the transferee, freed and discharged from all liability on account of the mortgage, charge or covenant charge, or of any mortgage, charge or covenant charge registered subsequent thereto.

¹⁰¹ [1952] VLR 470

¹⁰² [1922] 2 Ch 449

¹⁰³ [1939] SASR 298

This means that when a transfer pursuant to a mortgagee sale is registered, the Registrar-General will remove the mortgagee's mortgage from the register, and will remove all subsequent registered mortgages from the register.

3. The Registrar's duties

As noted previously, the Registrar-General has a general duty not to register instruments when there is some reason for him to believe that the transaction giving rise to the instrument is invalid, without first satisfying himself that the transaction is indeed valid - see *Re Douglas*¹⁰⁴.

4. The purchaser's position

i) Section 113(1) of the Conveyancing Act

Section 113(1) of the Conveyancing Act (which applies to Old System and registered mortgages) reads:

- 1) The receipt in writing of a mortgagee or chargee shall be a sufficient discharge for any money arising under the power of sale conferred by this Act, or for any money or securities comprised in his or her mortgage or arising thereunder, and a person paying or transferring the same to the mortgagee or chargee shall not be concerned to inquire whether any money remains due under the mortgage or charge or to see to the application of the money or securities so paid or transferred.

This sub-section allows the purchaser to pay the purchase price of the security to the mortgagee and that such payment will be a good discharge. The sub-section further provides that the purchaser is not obliged when paying money to the mortgagee to make inquiries as to whether or not any money is in fact owing to the mortgagee under the mortgage, and is not obliged to ensure that the mortgagee properly applies the money after receipt.

ii) Section 58(2) of the Real Property Act

Section 58(2) of the Real Property Act reads:

- 2) No such purchaser shall be answerable for the loss, misapplication, or non application, or be obliged to see to the application of the purchase money by the purchaser paid, nor shall the purchaser be concerned to inquire as to the fact of any default or notice having been made or served as referred to in section 57 (2).

The fact that the purchaser "shall not be concerned to inquire" into the issue or service of a 57(2)(b) notice connotes is that the purchaser is entitled to assume that such a notice has been correctly issued and served unless the purchaser knows otherwise. This section has a counterpart in section 112(3) of the Conveyancing Act (which does not apply to registered mortgages).

¹⁰⁴ 19280 29 SR (NSW) 48

iii) Protection of the purchaser

Under Old System title, a mortgagor possessed only an equitable interest in the security (an equity of redemption) thus the mortgagor's priority as against any incoming purchaser from the first mortgagee was a contest between two equitable interests. This meant notice by the purchaser of any defect in the mortgagee's power of sale was of great importance.

Under the Real Property Act, prior to registration of the transfer, a purchaser is in a similar position to an Old System purchaser of land as the purchaser holds only an equitable interest in the security (except to the extent that RPA section 43A may deem the interest to be a legal interest for some purposes if a registrable dealing is held). The mortgagor is a registered proprietor and thus would normally have priority as such over the purchaser in any contest between their respective interests. Provided, however, that the mortgagee exercises its power of sale in good faith, the contract for sale is binding also on the mortgagor (see *Forsyth v Blundell*¹⁰⁵ at 499 per Walsh J).

In cases where a mortgagee attempts to sell the security notwithstanding lack of power of sale, the purchaser's position prior to registration of the transfer is no stronger than that of the mortgagee, even if the purchaser has no notice of the defects in the power of sale (once again see *Forsyth v Blundell*¹⁰⁶ at 499 per Walsh J). This is because as registered proprietor the mortgagor's interest has priority over the equitable interest of the purchaser, and as the mortgagee lacked power to enter into the contract the purchaser cannot enforce the contract against the mortgagor.

Croft and Johannsson in *The Mortgagee's Power of Sale*, 2nd Edition at 10.9 and 10.10 cast doubt on the correctness of the comments of Walsh J in *Forsyth v Blundell* and suggest that the question of whether or not protection is conferred prior to registration "cannot be regarded as settled". The authors note that Mason J, the other judge in the majority in *Forsyth v Blundell* declines to express a view on whether "an exercise by the mortgagee of his power of sale is binding on the mortgagor, before completion, unless the power of sale was not exercised bona fide", and then suggest that Walsh J's conclusions as to the protection afforded to a purchaser prior to registration are unsupported by Mason J's judgment. Mason J, however, expressly agreed with Walsh J's conclusions with only the abovementioned exception, and as he concurred with the orders proposed by Walsh J he was also clearly of the opinion that the purchaser in that case was not entitled to priority over the mortgagor's interest notwithstanding the fact that the purchaser had no knowledge of the defect in the power of sale, and thus *Forsyth v Blundell* can be taken as binding High Court authority for that proposition.

It thus follows that section 113(1) of the Conveyancing Act and section 58(2) of the Real Property Act confer little if any protection on the purchaser prior to registration, as the degree of notice by the purchaser of defects in the power of sale is not relevant to determining the priority question between the purchaser and the mortgagor.

There is a disincentive for a purchaser to make enquiries as after registration the purchaser's indefeasibility of title could then be subject to challenge on the grounds of

¹⁰⁵ (1973) 129 CLR 477

¹⁰⁶ (1973) 129 CLR 477

fraud or personal equity, and the fact that the purchaser has had notice prior to registration that the mortgagee's power of sale is defective will likely be of considerable assistance to a mortgagor seeking to set aside the transfer.

In *Latec Investments Pty Ltd v Hotel Terrigal Pty Ltd*¹⁰⁷, Hotel Terrigal Pty Ltd mortgaged its hotel premises to Latec Investments Pty Ltd. Hotel Terrigal fell into default and Latec sought to sell the hotel by way of mortgagee sale. The decision to sell the property was made on 24 September 1958, but the auction was fixed for Friday 3 October 1958. The setting of this date meant not only that there was only a week to advertise the sale, but also that the auction date fell on a Friday, which was held to be a bad day for sales of this nature.

A very high reserve price was set for the auction - £85,000 when previous valuations had suggested the hotel was worth approximately £56,500 - which effectively ensured that the auction would be unsuccessful. The amount owing under the mortgage at the time was approximately £86,000. The property was passed in, with the highest bid being £58,000. No attempt was made to negotiate with any of the bidders, but instead the hotel was sold by Latec to its subsidiary, Southern Hotels Pty Ltd, for £60,000. There was no bargaining over this price, the price simply being fixed by Latec and Southern's common board of directors.

Approximately 5 years after the sale, Hotel Terrigal sought to set aside the sale, the hearing being before Else-Mitchell J. In the course of that 5 year period, however, Southern had charged its assets, including the hotel, to MLC Nominees Ltd. MLC gave value for the charge and did so without notice of the circumstances of the sale to Southern. MLC's charge was not registered on the title, and so was an equitable interest.

Despite the fact that the sale to Southern was arguably not at an undervalue, the High Court found that the sale was a fraud. As Menzies J stated at 288:

this sale by Latec to Southern was not an honest sale... The auction could well be regarded as nothing but a piece of camouflage to hide Latec's plan for a private sale to a subsidiary company and to provide a not-too-high figure as the minimum at which the sale might, with some measure of safety, be made. It was argued by Mr. Maloney for the appellant that the price of £60,000 was in fact a fair price, but the evidence does not warrant this Court in making such a finding. There was evidence for and against such a conclusion but, without making any finding as to the value of the Terrigal Hotel in November 1958, Else-Mitchell J found that the sale was made not in good faith, and this was a finding open on the evidence.

In the circumstances, the Court found that Hotel Terrigal had a right as against Southern to set aside the sale, but that left for determination the relative priorities of Hotel Terrigal and MLC. Given the registration of the transfer to Southern, Hotel Terrigal was no longer a registered proprietor, but possessed merely an equitable right to approach the Court to set aside the sale. This equity was found to rank behind the equitable interest of MLC, being a bona fide purchaser of its charge for value without

¹⁰⁷ (1965) 113 CLR 265

notice. For this reason the sale was not set aside, notwithstanding the fraud, as to set aside the sale would destroy MLC's priority interest.

I. The Court's discretion to halt or set aside a sale

1. The rule that the mortgagor must pay the principal into Court

If the mortgagee decides to exercise its power of sale, and is acting properly, the Court will only grant an injunction to stop the mortgagee from entering into a contract for sale if the mortgagor tenders to the mortgagee, or pays into Court the principal, interest and costs owing: *Inglis v Commonwealth Trading Bank of Australia*¹⁰⁸ (Decision of Walsh J affirmed by the High Court of Australia on appeal). This might arise, for example, if the mortgagor disputes the amount of the mortgage debt, or has a claim for damages against the mortgagee. An injunction will only then only be granted to prevent exchange of contracts if payment is made into court.

2. Exceptions to the rule

The rule in *Inglis v Commonwealth Trading Bank of Australia* includes the following exceptions:

1. where the mortgagee has failed to give a proper or valid notice (e.g., notice of demand or default under the mortgage);
2. where the amount of the debt claimed is clearly wrong or excessive on the terms of the mortgage;
3. where there is an issue as to validity or enforceability of the mortgage;
4. where there is an issue as to whether a condition precedent to the power of sale, either in the terms of the mortgage or by statute, has occurred: *Allfox Building Pty Ltd v Bank of Melbourne Ltd* (1992) NSW Conv R 55-634 at 59,627;
5. where the mortgagee has not acted in good faith in relation to the sale: *Waring (Lord) v London and Manchester Assurance Co Ltd* [1935] Ch 310 (CA) at 317, or on the grounds that the mortgagee has failed to exercise his or her powers bona fide: *Harvey v McWatters* (1949) 49 SR (NSW) 173.

3. The power to injunct sales under the Trade Practices Act

In *Town & Country Sport Resorts (Holdings) Pty Ltd v Partnership Pacific Limited*¹⁰⁹, the Federal Court considered, by way of obiter dicta, the Court's power to restrain misleading and deceptive conduct under section 80 of the Trade Practices Act 1974 (Cth), and how it related to the court's injunctive power under the general law to stop a sale by a mortgagee.

The Court's injunctive power under section 80 is not confined to the equitable principles, and may lead to the granting of "interlocutory or final injunctive relief that

¹⁰⁸ (1972) 126 CLR 161 at 164-65

¹⁰⁹ (1988) 20 FCR 540

does not correspond with what would follow from application of the traditional rules.” (at 545). However the Court can exercise its discretion in granting injunctive relief under section 80 by referring to the traditional rules as a guide. This includes requiring the mortgagor to secure payment of the mortgage debt before restraining the mortgagee from selling.

The requirement to pay the mortgage debt into court before a court stops a sale, as stated in *Inglis v Commonwealth Trading Bank of Australia*, can be relaxed if “the mortgagor’s proceedings involve an attack upon the enforceability of the security documents.” (at 545). This mirrors the exceptions to the rule as outlined in *Allfox Building Pty Ltd v Bank of Melbourne Ltd*.

If, for example, a mortgagor engages in misleading and deceptive conduct, and that conduct is clearly connected to the formation of the mortgage documents, a court might more readily restrain a mortgagee sale without requiring payment of the mortgage debt into court. This is particularly so when the mortgagor is able, on the grounds of such conduct, to seek orders varying or setting aside of a mortgage under section 87, because that involves an attack upon the enforceability of the mortgage.

4. Practical application of the rule

As Hedigan J expressed in *Nicholas John Holdings v ANZ Banking Group*¹¹⁰, for a court to grant an injunction, it must be satisfied that there is evidence to support each element of the claim for relief, so that there is a serious question to be tried. If there is a serious question, but the claim itself is weak, the Court may, on the balance of convenience test, require the claimant to pay into court an amount sufficient to meet the mortgage debt.

The reason the rule so seldom comes into play is that one or more of the previously-stated exceptions to the rule in *Inglis* is present in almost any defended mortgage proceedings. Typically the mortgagor:

1. challenges the validity of the mortgage on the grounds of unconscionability
2. disputes service of the statutory notice
3. challenges the existence of a default.

5. The rule under the Contract's Review Act

The remedies available to a mortgagor under section 87 of the TPA, such as a declaration that the whole or any part of a mortgage is void, or an order varying the terms of the mortgage, are similar to the remedies available under section 7 of the Contract Review Act 1980 (NSW). Accordingly, one could apply the obiter dicta in *Town & Country Sport Resorts (Holdings) Pty Ltd v Partnership Pacific Limited* to argue that if the grounds to support the available relief under section 7 are clearly connected with the formation of the mortgage documents sought to be varied or rendered unenforceable, then a court may exercise its discretion to relax the requirement of the mortgagor to pay the principal into court.

¹¹⁰ [1992] 2 VR 715 at 724

Section 7 is subject to section 19, which means that a court cannot vary or declare void a registered mortgage. However, a court can order that another instrument be executed to vary, terminate or otherwise affect the operation of the registered mortgage.

While a court may on these facts relax the requirement of the mortgagor to pay the mortgage debt into court, it is discretionary. If the mortgagor disputes only the amount of the interest, and does not dispute the principal, in those circumstances a court may refer to the principles outlined in *Inglis v Commonwealth Trading Bank of Australia* as guidance, and decide not to grant an injunction unless the mortgagor pays the principal into court.

6. When does the court's power to injunct the power of sale end?

The Court's discretion to grant an injunction restraining a sale continues up until completion. After completion, the Court cannot restrain a sale by granting an injunction. It can then only set aside the sale if the purchaser was aware of some impropriety in the sale at the time of exchange, or between exchange and completion. If the transfer has been registered, the ability to set aside the sale is further limited to cases involving fraud on the part of the purchaser or where a personal equity exists between the person seeking to set aside the sale and the purchaser such that the Court will compel the purchaser to reconvey the property.

The Court can certainly grant an injunction restraining a mortgagee from exchanging contracts (pursuant to an otherwise proper exercise of the power of sale) if payment is made to the Court. It also follows from the authorities (*Waring (Lord) v London and Manchester Assurance Co Ltd*¹¹¹ and *Forsyth v Blundell*¹¹²) that the Court can grant an injunction after exchange of contracts, and before completion, if the mortgagee exercised the power of sale in bad faith, or if the mortgagee has not properly exercised the power of sale.

7. Standing to seek an injunction

Persons who have an interest in the proceeds of sale, including subsequent mortgagees, and the mortgagor, have standing to seek an injunction. In *Jarrett v Barclays Bank Ltd*¹¹³, Morton LJ (at 192-3) held that the husband, as executor of his wife, had no *locus standi* to complain about a mortgagee sale, because the wife was declared bankrupt, and her property passed to the trustee in bankruptcy. He had no present interest in the proceeds of sale.

8. Status of the bona fide purchaser

A bona fide purchaser for value without notice who registers a transfer of the land is protected under the Real Property Act through s 42 indefeasibility.

¹¹¹ [1935] Ch 310 (CA)

¹¹² (1973) 129 CLR 477 at 499

¹¹³ [1947] Ch 187

If registration has not yet occurred, the purchaser has a lesser degree of protection under RPA s 43A provided the transfer is in registrable form. The section deems the purchaser to have a legal estate in the land for some purposes, although this deeming provision is only of assistance in a priority contest against equitable interests in the land, and thus confers no protection against a mortgagor claiming that there was a defect in the mortgagee's power of sale.

As previously stated, prior to registration a purchaser's right to the security is no better than the mortgagee's right to sell it, regardless of the bona fides of the purchaser.

9. Termination of the equity of redemption

The mortgagor's equity of redemption has been defined as an equitable interest in the land, so that in equity the mortgagor is the owner of the land, subject to the mortgage. Once contracts are exchanged, the equity of redemption is suspended. It is finally extinguished once completion takes place.

By way of example, if a mortgagor defaults in payment, and fails to comply with any default notices, the mortgagee can then exercise its power of sale. The mortgagee effectively exercises power of sale once he or she enters into a binding contract for the sale of the mortgaged property: *Forsyth v Blundell*¹¹⁴. Up until exchange the mortgagor's equity of redemption and its equitable right to redeem continue to exist. However, once contracts are exchanged, the equity of redemption is suspended. It is not extinguished at this point, because the equity of redemption can become exercisable again if the binding contract is not completed. If the contract for sale is completed, the equity of redemption is finally terminated.

While the equity of redemption is merely suspended between exchange and completion, it does not remain in force following completion or registration: *Waring (Lord) v London and Manchester Assurance Co Ltd*¹¹⁵.

Of course, with respect to Real Property Act land the mortgagor's right is not confined to an equitable interest, in so far as the mortgagor is a legal owner of the security by virtue of being a registered proprietor. The expression "equity of redemption" is, however, still sometimes used to describe a mortgagor's rights with respect to Real Property Act land despite the anachronism.

10. The Courts considerations when granting an injunction

In a case where contracts have not been exchanged, the Court's decision whether or not to grant an injunction usually involves only the rights and convenience of the mortgagor and the mortgagee, although the interests of other mortgagees and/or a tenant sometimes come into play. The primary question in this case is whether the mortgagee has power of sale.

¹¹⁴ (1973) 129 CLR 477

¹¹⁵ [1935] Ch 310 (CA) at 317 – 318

After exchange but before completion, the purchaser has an equitable interest in the security, and the purchaser's rights must thus also be considered. The purchaser at this stage only has an equitable interest, whilst the mortgagor has a legal interest, thus in a priority contest the mortgagor will normally prevail. The purchaser's interests will, however, be relevant to the balance of convenience the Court will look at when considering whether to issue an interlocutory injunction.

After registration the purchaser has an indefeasible title, subject only to any fraud on the part of the purchaser or any personal equity against the purchaser.

J. Duties to other mortgagees and guarantors

1. Owed by the first registered mortgagee

A first registered mortgagee can exercise the power of sale for his or her own benefit, so that the mortgagee can realise the mortgage debt from the proceeds of sale. The first registered mortgagee does not require the consent of other mortgagees, however he or she must account to them for any surplus proceeds.

The mortgagee can decide when to sell, and is not obliged to postpone the sale in order to obtain a better price. A mortgagee is entitled to have regard primarily to his or her own interests (*Forsyth v Blundell*¹¹⁶). However a first mortgagee must also act in good faith, and must not deliberately sacrifice the interests of the second or subsequent mortgagee.

A first registered mortgagee owes a duty of good faith to subsequent mortgagees in selling the mortgaged property. In Australia, the duty of good faith does not necessarily extend to a duty to take reasonable care to obtain the true market value at the time at the time he or she chooses to sell the property, which is a principle supported by the English authorities.

The duty of good faith is owed to second and third mortgages: *Southern Goldfields Ltd v General Credits Ltd*¹¹⁷ & *Alliance Acceptance Co Ltd v Graham*¹¹⁸.

In *Pendlebury v Colonial Mutual Life Assurance Society Ltd*¹¹⁹, (in the context of the duty of good faith owed to a mortgagor) the High Court expressed the view that a mortgagee must not sacrifice recklessly or willfully the interests of the mortgagor, and that if he or she does then they have not acted in good faith. This duty extends to subsequent mortgages: *Cuckmere Brick Co v Mutual Finance Ltd*¹²⁰.

In *Jacobson v National Australia Bank*¹²¹, the plaintiff, a second mortgagee, sought to restrain the first mortgagee, the defendant, from proceeding to sell the mortgaged

¹¹⁶ at 493-4

¹¹⁷ (1991) 4 WAR 138

¹¹⁸ (1974) 10 SASR 220

¹¹⁹ (1912) 13 CLR 676

¹²⁰ [1971] Ch 949

¹²¹ (Victorian Supreme Court - unreported judgment) 15 April 1994 BC9401236

property. The plaintiff alleged that the first mortgagee owed to him a duty to recover the highest possible price, and that it failed to do so. Beach J disagreed and appeared to adopt a similar view to that of the High Court in *Pendlebury*:

“In my opinion, it is strongly arguable that the only duty a first mortgagee owes to a second mortgagee is a duty to protect the second mortgagee’s financial interest in the property.”

In the above case, neither the proceeds of sale nor the higher offer would produce a surplus for the second mortgagee. Beach J continued “...in that situation Dr Jacobson would have the greatest difficulty in establishing that he has suffered any financial loss by reason of the sale.”

2. Owed by a subsequent mortgagee

A subsequent registered mortgagee can sell the land free of prior registered mortgages by applying the proceeds of sale towards the discharge of the prior registered mortgages. On settlement the prior mortgagee hands over a discharge in registerable form which must be lodged with the transfer under power of sale in order for the transfer to be registered.

In relation to subsequent registered and unregistered mortgages, a registered mortgagee who exercises a power of sale must act in good faith in the sale. The mortgagee must also account to the subsequent mortgagees for any surplus of proceeds of sale, in order of priority.

3. Selling the land subject to a prior mortgage

In *Manser v Dix*¹²², the trustee for sale of the mortgaged property was held to have validly sold the property, subject to the mortgage, even though the mortgagee argued that the trustee had no power to sell.

The mortgagee submitted that the terms of the trust prevented the trustee from selling the property without first paying off the mortgage. The Court disagreed, and held that the terms of the trust allowed the trustee to pay off the mortgage (with the mortgagee’s concurrence), or alternatively sell the property subject to the mortgage without the concurrence of the mortgagee.

Applying this authority to the sale by a subsequent mortgagee pursuant to a power of sale, it would appear that a subsequent mortgagee with a power of sale may sell subject to a prior mortgagee without the concurrence of the prior mortgagee.

¹²² (1857) 44 ER 561

4. The position of the subsequent equitable mortgagee

The law in Australia is uncertain as to whether an equitable mortgagee can convey the legal estate in the property. This is important because the statutory powers of sale are not available to equitable mortgagees.

If the equitable mortgage has a power of attorney enabling the equitable mortgagee to convey the legal estate, or the mortgagor declares a trust which empowers the mortgagee to remove the mortgagor as trustee and appoint the purchaser as trustee on sale, then the equitable mortgagee can convey the legal estate. In that case, the statutory power of sale under section 109 Conveyancing Act 1919 (NSW) applies.

Further, if an equitable mortgage contains an agreement, express or implied, to create a legal mortgage, the statutory power of sale is available. Section 112(1) of the Act then applies by giving the mortgagee power to convey the property free from all interests over which the mortgage has priority, but subject to any interests which have priority to the mortgage. Accordingly, the equitable mortgagee can exercise a power of sale subject to any prior registered mortgages, and in this regard owes the same duties as a legal mortgagee: *Palmer v Barclays Bank Ltd*¹²³.

If an equitable mortgage does not contain an express or implied power of sale (by deed or power of attorney), the statutory powers of sale enjoyed by legal mortgagees are not available to equitable mortgagees. An equitable mortgagee must apply to the Court to sell the mortgaged property pursuant to section 103 Conveyancing Act 1919 (NSW). While section 103, by virtue of section 90, does not strictly apply to mortgages of Torrens System land, the Court has an inherent equitable right to order judicial sale for Torrens mortgages: *Yarrangah Pty Ltd v National Australia Bank Ltd*¹²⁴ where Young J stated at paragraph 30:

Accordingly, in my view, the probability is that there is an equitable power to award judicial sale at the suit of a mortgagor where the circumstances show that there is clear prejudice from the application of the ordinary methods of foreclosure or sale under a power of sale.

If the Court orders the sale of a mortgaged property, on the application of an equitable mortgagee, the Court may make vesting orders, that is

1. an order conveying land or appointing a person to convey the land, or
2. an order vesting the legal estate in the land in the mortgagee so that the mortgagee can carry out the sale.

The Court can also order the sale on terms that a sum sufficient to meet the costs of sale be deposited with the Court. Further, the Court may require the equitable mortgagee to pay into a court a sum sufficient to secure any prior mortgagee against loss. This condition may be required where the expectation of a surplus for subsequent mortgagees is speculative. A Court will not order a sale on the request of a second or subsequent mortgagee if the security is deficient, and a sale would not benefit any party.

¹²³ (1971) 23 P & CR 30

¹²⁴ [1999] NSWSC 97

5. The position of the guarantor

In *Oayda v Mercantile Mutual Life Insurance Company Ltd*¹²⁵, Lindgren J (at 226-27) discussed the nature of the mortgagee's duties in exercising a power of sale, and noted that the English authorities, which favour a higher duty to take reasonable care to obtain the best possible price, depart from the formulation favoured by the Australian authorities, which is simply a duty to act in good faith, "or a duty not to act willfully or recklessly thereby 'sacrificing' the mortgagor's interest."

Applying the Australian formulation to the duties owed by a mortgagee to a guarantor (a person interested in the proceeds of sale), Lindgren J observed (at 227) that a number of cases have considered the position of guarantors in the context of sales by a mortgagee. His Honour then made the following comments:

A duty of care in favour of the guarantor is recognized in England...but in Australia it may be that the mortgagee's duty to the guarantor is, apart from the duty of good faith referred to earlier, limited to an equitable duty not to destroy the security or reduce its value.

The view that a mortgagee's duty to a guarantor is merely not to destroy or reduce the value of the security, as opposed to the higher duty to take reasonable care in obtaining the best possible sale price, is supported by the comments of Beach J in *Jacobson v National Australia Bank*, even though the comments were in the context of the duty owed to a subsequent mortgagee.

6. The power of the Court to order the security sold

Section 103(2) of the Conveyancing Act reads:

In any proceedings, whether for foreclosure, or for redemption, or for sale, or for the raising and payment in any manner of mortgage money or an amount secured by a charge, the Court, on the request of the mortgagee or person whose land is subject to the charge, or of any person interested either in the mortgage money or amount so secured or in the right of redemption, and notwithstanding the dissent of any other person, and notwithstanding that the mortgagee or person whose land is subject to the charge or any person so interested does not appear in the proceedings, and without allowing any time for redemption or for payment of any mortgage money or amount so secured, may direct a sale of the mortgaged or charged property on such terms as to the Court may seem just, including, if the Court thinks fit, the deposit in court of a reasonable sum fixed by the Court to meet the expenses of sale and to secure performance of the terms.

Where the mortgagee is actively pursuing its statutory or contractual power of sale, the court will not usually exercise its discretion to order judicial sale. There must exist special or exceptional circumstances, for example where the mortgagee's decision to postpone sale will cause unfairness and injustice to the person or persons interested. However, courts will order a sale, even if it is against the wishes of the mortgagee, if it is just and equitable in the circumstances to do so.

¹²⁵ (1995) 152 ANZ Conv R 225

In *Palk v Mortgage Services Funding plc*¹²⁶, the English Court of Appeal ordered a sale (on the application of the mortgagor), notwithstanding both the mortgagee's objection and a deficiency in the sale price (which was not enough to satisfy the mortgage debt). The Court held that it was just and equitable in the circumstances to order the sale. The reason for the decision was that the rental income expected by the mortgagee (from the mortgagee's wish to postpone the sale) was far less than the interest that would have been saved by selling the house.

In *Sandgate Corporation Pty Ltd (In liq) v Ionnou Nominees Pty Ltd*¹²⁷, Steytler J dealt with the Western Australian equivalent to section 103(2), section 55(2) of the Property Law Act 1969. In that case, a number of mortgagees who shared in a first registered mortgage opposed an application by the mortgagor for a judicial sale under section 55(2). The Court granted the application, and held that section 55 empowers a court to require a mortgagee to discharge a mortgage otherwise than on payment of the entire mortgage debt. Steytler J further held that provided the Court exercises the power of sale under section 55 in circumstances where it is clear that the mortgagee's entitlement will be satisfied out of the proceeds of sale, then the exercise of that power is not inconsistent with the mortgagee's right of foreclosure.

While section 103, by virtue of section 90, does not strictly apply to mortgages of Torrens System land, the Court has an inherent equitable right to order judicial sale for Torrens mortgages: *Yarrangah Pty Ltd v National Australia Bank Ltd*¹²⁸.

In the case of *Sandgate Corporation Pty Ltd (In liq) v Ionnou Nominees Pty Ltd* the mortgagor applied for a judicial sale. However, a subsequent mortgagee can apply for a judicial sale under section 103(2), because a subsequent mortgagee has an interest in the right of redemption. In light of the decisions in *Palk v Mortgage Services Funding plc*¹²⁹ and *Sandgate Corporation Pty Ltd (In liq) v Ionnou Nominees Pty Ltd*, it is possible that a court will order a sale, against the mortgagee's wishes, on the application of a subsequent mortgagee.

The words of section 103(2) are clear: "notwithstanding the dissent of any other person", on the request of "a mortgagee", or "any person interested in the mortgage money... or in the right of redemption", the Court may direct a sale. Therefore, any person interested in the equity of redemption, such as a subsequent mortgagee, or even a surety (who is entitled to redeem on the basis of his or her right to pay off the debt) may apply to the Court for a sale.

If a guarantor of a mortgage debt pays the debt, he or she has the right to redeem. Accordingly, the guarantor would then fall within the class of persons "interested either in the mortgage money or amount so secured or the right of redemption...":section 103(2). If this is so, it would appear that a guarantor can apply to the court to have the land sold under section 103(2), even if it is against the mortgagee's wishes.

¹²⁶ [1993] Ch 330

¹²⁷ (2000) 22 WAR 172

¹²⁸ [1999] NSWSC 97

¹²⁹ [1993] Ch 330

K. Damages for improper sale

A mortgagor and subsequent mortgagees are entitled to damages for a mortgagee's improper exercise of the power of sale. Even a guarantor who suffers a loss as a result of a mortgagee's failure to act in accordance with the duty he or she owes in the exercise of a power of sale, has been held to be entitled to damages: *Higton Enterprises Pty Ltd v BFC Finance Ltd*¹³⁰. This is because the guarantor of a mortgagor's obligations to a mortgagee is exposed if the mortgagee, in breach of the duty of good faith owing to a guarantor, sells a property for a price significantly less than its true value and the amount of the mortgage debt.

The above are classed as persons "damnified" by the mortgagee's improper or irregular exercise of power: section 112(3)(b) Conveyancing Act.

1. Calculation of Damages

In *Jenkins v National Australia Bank Ltd*¹³¹, Phillips JA stated the general principle as follows:

Where a mortgagee who sells mortgaged property acts in breach of the duty he owes to the mortgagor... the mortgagor is entitled to be compensated for the loss thereby sustained and not uncommonly the measure of that loss will be the difference between the amount realised by the mortgagee and the "amount which would have been realised on a sale of the property conducted without willful default: *Pendlebury v Colonial Mutual Life Assurance Society Ltd* (1912) 13 CLR 676 at 692.

In *Jenkins v National Australia Bank Ltd*, the mortgagee breached its duty to the mortgagor by failing to preserve the property, which was a reception centre, with the result that by the time of sale the property had diminished in value. Due to the unsatisfactory and unpersuasive nature of the valuation evidence tendered by the mortgagors at trial, Phillips JA agreed with the trial judge's assessment of damages, namely the restoration costs necessary to enable the business of a reception centre to be re-opened on the property.

It appears from *Jenkins* that a court may approach the assessment of damages by considering the probable selling price had the mortgagee not allowed the property to deteriorate in the first place (i.e., not breached its duty to preserve the value), provided that there is sufficient evidence to prove that the property would have been sold at the price claimed. Due to the insufficient valuation evidence, the court in *Jenkins* properly adopted the cost of restoring the property as the measure of damages.

¹³⁰ [1997] 1 Qd R 168

¹³¹ (1999) V Conv R 54-602

2. Distribution of damages

In *Downsview Ltd v First City Corporation Ltd*¹³², Lord Templeton stated at 311:

If a first mortgagee commits a breach of his duties to a mortgagor, the damage inflicted by that breach will be suffered by the second mortgagee, the subsequent encumbrancers and the mortgagor, depending on the extent of the damage and the amount of each security.

If subsequent encumbrancers sue the mortgagee for an improper exercise of power of sale (for example selling property far below the true value), the damages are distributed in the same way as proceeds of sale are distributed, in order of priority of the encumbrancers. The subsequent encumbrancer will satisfy the outstanding debt due to him or her, and forward any surplus of the damages to the next encumbrancer (so they can satisfy their debts out of the damages remaining) or to the mortgagor.

L. Distribution of proceeds of power of sale

1. General rules

Section 112 of the Conveyancing Act regulates the disposal of the proceeds of a power of sale exercised under section 109 of that Act. An unregistered mortgagee however is in fact not exercising its “power of sale” pursuant to section 109.

An equitable mortgagee requires the assistance of the Court in order to sell property in which it has no legal interest. Such a mortgagee inherently carries with it a right to obtain possession with the assistance of the Court: *Barclays Bank Ltd v Bird*¹³³.

This was made clear in *Guardian Mortgages v Miller*¹³⁴, where Wood CJ at CL said:

In *Yarrangah Pty Ltd v National Australia Bank Ltd* (1999) 9 BPR 17,061, Young J held that although section 103 of the Conveyancing Act was not applicable to Real Property Act land, there is an inherent power in a Court of Equity to order judicial sale with respect to Real Property Act land in circumstances analogous to those where an order for sale under section 103 would be available in relation to Old System land. It follows that the Plaintiff requires the assistance of an order of the Court for judicial sale, analogous to an order for sale under section 103 of the Conveyancing Act.

Accordingly, there is no conflict between the provisions of Sub-section 112 (4) any orders made by the Court for judicial sale. The equitable mortgagee is selling the property in question with the assistance of the Court and not as an exercise of a statutory power.

¹³² [1993] AC 295

¹³³ [1954] 1 Ch 274

¹³⁴ [2004] NSWSC 1236

This was made clear in the recent decision of Campbell J in *King Investment Solutions Pty Ltd v Fahmi Mustafa Hussain & anor*¹³⁵ where it was said:

However there is a more fundamental problem lying in the way of the second mortgagee exercising a power of sale conferred by section 109 in a way that is likely to provide it with a commercially effective remedy. It is that as a matter of construction of the power in section 109, it does not enable an unregistered second mortgagee of Real Property Act land to sell the interest of the first mortgagee in the land. A sale of the land subject to the interest of the first mortgagee is unlikely to prove attractive to potential purchasers.

There are two reasons for concluding that the power of sale under section 109 does not enable the unregistered second mortgagee to sell the interest of the first mortgagee. The first is that section 109 itself says that the power of sale (and other powers conferred by section 109) are conferred “to the like extent as if they had been in terms conferred by the instrument creating the mortgage ... but not further...”. It would not be possible for a contract between a mortgagor and a second mortgagee of land to empower the second mortgagee to convey the interest of the first mortgagee, unless the first mortgagee consented or in some other way conferred authority on the mortgagor to affect its interest in the land. Thus, the statutory power of sale under section 109 can stretch no further.

The second is that section 112(1) Conveyancing Act sets out the effect of exercise of the statutory power of sale, namely that the mortgagee can ... convey the property sold for such estate and interest therein as is the subject of the mortgage ... , freed from all estates, interests, and rights to which the mortgage ... has priority, but subject to all estates, interests, and rights which have priority to the mortgage...

In this way, the statute itself recognises that the second mortgagee cannot convey the interest of the first mortgagee. See also *Guardian Mortgages v Miller*¹³⁶ ; *Re Hodson and Howes’ Contract*¹³⁷ .

Subsection 112 (4) of the Conveyancing Act states:

“The money which is received by the mortgagee or chargee, arising from the sale, after discharge of prior incumbrances to which the sale is not made subject (if any), or after payment into court under this Act of a sum to meet any prior incumbrance, shall in the absence of an express contract to the contrary be held by the mortgagee or chargee in trust to be applied by the mortgagee or chargee, first in payment of all costs, charges, and expenses properly incurred by the mortgagee or chargee as incident to the sale or any attempted sale or otherwise; and, secondly, in discharge of the money, interest, and costs, and other money (if any) due under the mortgage or charge and the residue of the money so received shall be paid to the person entitled to the mortgaged or charged property or authorised to give receipts for the proceeds of the sale thereof.”

¹³⁵ at 63

¹³⁶ [2004] NSWSC 1236 at [120]

¹³⁷ (1887) 35 Ch D 668; F&L para [20.39]

It should be noted from the outset that this section only has application with respect to Old System Title Land and not Torrens Title Land (see *Baypoint Pty Ltd v Baker*¹³⁸ at 4 per Young J and Section 6 of the Conveyancing Act 1919).

The effect of the subsection is that a mortgagee must, after satisfying his own debts, costs, charges and expenses etc hold the residue for “the person entitled to the mortgaged property”. This means surplus proceeds should only be paid to the mortgagor where there are no subsequent encumbrances.

Significantly, if the proceeds of sale are insufficient to discharge the mortgage debt, the mortgagee may subsequently sue on any personal covenant to recover the balance of the debt from the mortgagor unless there are provisions in the mortgage to the contrary: *Commonwealth Bank of Australia v Buffett*¹³⁹.

Subsection 58 (3) of the Real Property Act states:

The purchase money to arise from the sale of any such land, estate, or interest, shall be applied, first, in payment of the expenses occasioned by such sale; secondly, in payment of the moneys which may then be due or owing to the mortgagee, chargee or covenant chargee; thirdly, in payment of subsequent mortgages, charges or covenant charges (if any) in the order of their priority; and the surplus (if any) shall be paid to the mortgagor, charger or covenant charger, as the case may be.

This provision applies in circumstances where a mortgagee, chargee or covenant chargee is authorised by section 57 of the Real Property Act to exercise the powers conferred by the section.

Subsection 58 (3) provides that the proceeds of sale (with respect to Real Property Act Land) are to be apportioned in the following order:

1. Expenses associated with the sale;
2. Monies owed to the mortgagee, chargee or covenant chargee;
3. Monies owed under subsequent mortgages, charges or covenant charges (if any) in the order of their priority;
4. Balance to be paid to the mortgagor.

In relation to the extent of the mortgagee’s expenses, he or she is entitled to all the costs properly incurred in ascertaining or defending his rights, so far, that is, as he acts reasonably with respect to such rights as his mortgage title gives him. This will include costs in asserting or defending the mortgagee’s title, costs of proceedings to recover possession and the expenses of actually taking possession and costs to recover the mortgage debt (See *Maher v Network Finance Ltd*¹⁴⁰).

¹³⁸ (1994) Unreported NSWSC BC9403439

¹³⁹ (1993) 114 ALR 245)

¹⁴⁰ [1982] 2 NSWLR 503

As to the balance of the monies held by the mortgagee after payment of his mortgage Helsham J said in *Bank of New South Wales v Adams*¹⁴¹:

I hold that where a mortgagee of land under the provisions of the Real Property Act sells in pursuance of the power conferred by s58 then he holds any purchase money in excess of that required to pay the expenses occasioned by the sale and that due an owing to him in trust for subsequent mortgagees of whose interest he has notice.

2. Comparison of the two schemes

i) Differences

The proceeds arising under from a sale under section 58 of the RPA are not by reference to the wording of the statute, to be held in trust by the mortgagee as they would be following a sale governed by section 112 of the Conveyancing Act.

However Crawford J in *Re Morrison; Bennell v Smith*¹⁴² in considering similar provisions (to section 58 of the RPA) in the Tasmanian legislation held that a sale by a mortgagee of registered land constitutes that mortgagee trustee of the surplus proceeds.

In *Adams v Bank of New South Wales*¹⁴³, the majority (Huntley and Samuels JJA) applied *Re Morrison* in New South Wales. Further, the requirement under section 58 for a mortgagee to pay any surplus to any subsequent mortgagee does not arise under section 112.

The absence of such an obligation arising in section 112 is not however free from doubt. In *re Thomson's Mortgage Trusts*¹⁴⁴ Eve J made the following comments (at 513) in relation to the duty of a first mortgagee with respect to similar provisions (to section 112 of the Conveyancing Act) in the Conveyancing Law of Property Act 1881:

I do not think this attitude of the defendant Bruty can be justified. I think he is and always has been since his claims as first mortgagee were satisfied under a statutory obligation to pay the surplus to the plaintiff Wood as the person then entitled to the mortgaged property and authorized to give a receipt for the proceeds of sale thereof: see Conveyancing and Law of Property Act, 1881, s. 21, sub-s 3 and s. 22

ii) To what types of sale do they apply

Section 112 only has application with respect to Old System Title Land and not Torrens Title Land.

In *Baypoint Pty Ltd v Baker*¹⁴⁵ Young J noted (at 4):

¹⁴¹ [1982] 2 NSWLR 659 at 665

¹⁴² [1962] Tas SR 337

¹⁴³ [1984] 1 NSWLR 285 at 299

¹⁴⁴ [1920] 1 Ch 508

¹⁴⁵ (1994) Unreported NSWSC BC9403439

Under Old System title, the right of a second mortgagee to claim the surplus from a first mortgagee's sale now derives from s112 (4) of the Conveyancing Act. That sets up a statutory trust of the surplus in favour of "the person entitled to the mortgaged or charged property". For Torrens System land, s58 (3) of the Real Property Act again deals with the matter by requiring the first mortgagee to pay the surplus in payment of subsequent mortgages and thence to the mortgagor. Even apart from these statutory provisions, there is, under the general law, a trust of the surplus in favour of the subsequent encumbrancers and the mortgagor: *Charles v Jones* (1887) 35 Ch D 544; *Adams v Bank of New South Wales* [1984] 1 NSWLR 285, 295; *Lloyds Bank NZA Ltd v National Safety Council of Australia Victorian Division* (1993) 115 ALR 93, 102. See also Snell's Equity, 29th ed, p 416.

3. Payment priority

If surplus proceeds of sale are paid to the wrong person the mortgagee is liable to make good the deficiency to the person properly entitled.

In *West London Commercial Bank v Reliance Permanent Building Society*¹⁴⁶ this was held to be so in circumstances where the mortgagee paid the surplus to the mortgagor although it had notice of a second equitable mortgagee.

If the mortgagee has any doubts as to the proper person to whom to pay the surplus it may be paid into Court, by virtue of the provisions of section 95 of the Trustee Act 1925 (NSW).

Alternatively the mortgagee may invest it for the person properly entitled. Failure to take some action for the benefit of the person may make the mortgagee liable for interest on the surplus monies. In *Charles v Jones*¹⁴⁷ Kay J said (at 550) in holding that the mortgagee was responsible for interest:

But it has long been held that a mere stakeholder may avail himself of the Trustee Relief Act and pay the money which is in his hands into Court. The duty of this mortgagee was at least to set this money apart in such a way as to be fruitful for the benefit of the persons beneficially entitled to it...still when he has paid himself, and has money remaining in his hands which is no longer his property, how can he be treated as other than a trustee of such money?

Further, if a solicitor, or other agent pays surplus proceeds of sale to the mortgagor when he or she knows of a well founded claim against that person the solicitor or agent may be held to be a constructive trustee for the benefit of the claimant if he or she is either aware of the claim and the client's intention not to meet it or assists in avoiding the claim (*Lake v Bayliss*¹⁴⁸).

In the case of *Weld Blundell v Synott*¹⁴⁹, it was held that the first mortgagee could claim repayment of money paid to a second mortgagee under a mistake of fact. Two

¹⁴⁶ (1885) 29 Ch D 954 (CA)

¹⁴⁷ (1887) 35 Ch D 544

¹⁴⁸ [1974] 2 All ER 1114

¹⁴⁹ [1940] 2 KB 107

defences were raised. The first was that the mistake was not between the parties but between the first mortgagee and the mortgagor. In relation to this Asquith J said (at 113):

When what A owes to B depends on what A is owed by C, and A, owing to a mistake as to the later amount, automatically makes a mistake as to the former amount, there is in my view, a mistake not only as between A and C but as between A and B as well. I therefore hold that the defence mistake was not inter partes fails.

The second defence raised was that the first mortgagee was estopped by his representations to the second mortgagee, namely an account which was delivered and the payment itself. His Honour found in relation to this argument (at 114 and 115):

I do not think an estoppel arises unless it can be shown that there was neglect or misconduct on the plaintiff's part in making a representation. When the decisions as to estoppel in connection with the payment of money under a mistake of fact are closely examined, much seems to turn on whether the payer was subject to a duty as against the payee to inform him of the true state of the account – in effect, a duty not to make a mistake of fact in the regard.

Further, in circumstances where surplus proceeds are paid to the wrong person they may also be recoverable as moneys paid under a mistake of law (*David Securities Pty Limited v Commonwealth Bank of Australia*¹⁵⁰).

Given section 42 of the Real Property Act and the doctrine of indefeasibility of title that section has created, the order of registration of subsequent mortgages will normally be decisive on the question of the relative priorities between them. There are, however, circumstances where the priorities between subsequent mortgagees may differ from the order of registration, such as when fraud has taken place or when personal equities exist between the mortgagees. Thus a selling mortgagee cannot rely absolutely on the order of registration, and if an allegation is made that the priorities differ from the order of registration by reason of some exception to the doctrine of indefeasibility of title, the selling mortgagee will either need to investigate this allegation or pay the monies into court.

In *Butler v Fairclough*¹⁵¹, Griffith CJ equated the lodging of a caveat with notice that the registered proprietor's title is subject to the equitable interest claimed in the caveat. He said (at 91 and 92);

In a case for contest between two equitable claimants the first in time, all other things being equal is entitled to priority....A person who has an equitable charge upon the land may protect is by lodging a caveat, which in my opinion operates as notice to all the world that the registered proprietors title is subject to the equitable interest alleged in the caveat.

¹⁵⁰ (1992) 175 CLR 353

¹⁵¹ (1917) 23 CLR 78

In order to fully answer this question it is necessary to consider the circumstances in which there is either a failure to lodge a caveat by an unregistered mortgagee or at least a delay in this regard. *J & H Just (Holdings) Limited v Bank of New South Wales*¹⁵² showed that the holder of a prior equitable interest could under special circumstances prevent a subsequent holder of an equitable interest from being misled by means other than the lodging of a caveat.

In that case the registered proprietor executed a mortgage in registrable form to the bank which the bank was not registered. Although the bank did not lodge a caveat it retained the duplicate certificate of title. A further mortgage was created in favour of the plaintiff company which although it searched the register, failed to require production of a duplicate certificate of title. Barwick CJ, delivering the leading judgment, held that the bank's mortgage was entitled to priority despite the fact that it had not lodged a caveat. His Honour rejected the proposition that the failure of the holder of the prior equitable interest to lodge a caveat in respect of that interest must necessarily result in loss of priority. The Chief Justice said (at 554-5);

There may be situations in which (a failure to lodge a caveat) may combine with other circumstances to justify the conclusion that 'the act or omission proved against' the possessor of the prior equity 'has conducted or contributed to a belief on the part of the holder of a subsequent equity, at the time when he acquired it, that the prior equity was not in existence' ... This is the relevant principle to apply if it is claimed that the priority of a prior equitable interest has been lost in competition with a subsequent equitable interest.

The other reason given by Barwick CJ for not postponing the bank was that it had taken steps to protect itself by obtaining custody of the duplicate certificate of title which would foreseeably prevent the creation of further equitable interest.

In *Osmanoski v Rose*¹⁵³ Gowans J considered the situation where two prospective purchasers of a property in Victoria received a sale note from the vendor entitling each of them to an equitable interest in the property. The first prospective purchaser failed to lodge a caveat. Gowans J said (at 526);

Where there is other conduct on the part of the possessors of the subsequent equity to be considered, the failure on the part of the possessors of the prior equity to lodge a caveat is not conclusive.

Notwithstanding these remarks His Honour found that the second purchasers were induced to acquire their interest and pay the balance of the purchase moneys by the absence of any caveat on the register of the first purchase interest, and accordingly, the interest of the first was postponed to that of the second.

It follows that although the failure to lodge a caveat may cause an equitable interest-holder to lose priority, such loss of priority depends on all the circumstances of the case. Lodgement of a caveat confers no additional priority per se. Thus no firm conclusions can be drawn by a selling mortgagee by simply noting the order of

¹⁵² (1971) 125 CLR 546

¹⁵³ [1974] VR 523

lodgement of caveats without further investigation, although more often than not the order of lodgement will prove to be the same as the order of priority.

In *Baypoint Pty Limited v Baker*¹⁵⁴ there was a determination of a separate question before Young J raised in respect of the mortgage of which the plaintiff was the mortgagee and Brian Baker and Deborah Baker were the mortgagors. The separate question essentially involved whether the plaintiff as against the second defendant was entitled to be paid the moneys paid into the court by virtue of clause 3 of the mortgage. That clause stated:

Notwithstanding the preceding provisions the mortgagee acknowledges and agrees that the said Deborah Ann Baker shall have no personal liability for payment of the principal sum and the rights of the mortgagee shall be limited to the land mortgaged in so far as the said Deborah Ann Baker is concerned.

The land had been subsequently sold by the registered first mortgagee exercising its power of sale. His Honour said that one of two legal ramifications ensued:

- (a) there was substituted in every sense for the mortgaged land the fund constituted by the surplus; or
- (b) the result and fund could in no sense be said to be “land”.

His Honour went on to find that consequently there was no property vested in Mrs. Baker. That is because as soon as the first mortgagee exercised its power of sale, Mrs. Baker’s equity of redemption ceased to be enforceable by a court of equity and so ceased to exist.

His Honour concluded, after making reference to the relevant authorities that the better view of the construction of special condition 3 is that as soon as the first mortgagee sold the land, the plaintiff (the unregistered mortgagee) lost any right to Mrs. Baker’s share in the surplus. It followed that the separate question posed for determination of the court was answered “No”.

The problem encountered in *Baypoint* arose from the poor wording of an unusual clause inserted into the mortgage existing in that case. Thus the case does not raise a general difficulty in mortgage cases that needs to be cured by the insertion of a special standard term, but rather persons drafting special conditions in the nature of that in *Baypoint* limiting liability for a mortgagor should draft the same with caution.

4. Costs and expenses

As noted above, section 112 (4) of the Conveyancing Act allows the mortgagee to apply the proceeds of a sale “first in payment of all costs, charges, and expenses properly incurred by him as incident to the sale or any attempted sale or other wise”. There are similar provisions in section 58(3) of the Real Property Act.

Further at common law the mortgagee is entitled as of right to the costs properly incurred by him in an action for foreclosure or other action to enforce the mortgage

¹⁵⁴ (1995) 6 VPR 13687

and in an action against him for redemption. But the mortgagee may forfeit these costs by misconduct and may even have to pay the costs of such an action where he has acted vexatiously or unreasonably. The court departs from the general with reluctance however.

Costs of the mortgagee properly allowable include expenditure on proper advertising, preservation and improvement of the mortgage property if necessary to obtain a proper price on sale, the legal and other costs on sale and the costs involved in a proper payment into the court.

Parties are entitled to recover costs to the extent that they succeed in establishing their respective claims for priority and to the extent to which the fund is sufficient to pay the respective claims upon it: *Elderly Citizens Home of South Australia Inc. v Balnaves*¹⁵⁵. In *Elderly Citizens Homes*, DeBelle J, after previously determining the priorities of certain claimants to a fund remaining after the sale of property in South Australia, was left to consider the apportionment of various claims for costs. His Honour concluded:

A mortgage usually provides that the mortgagee is entitled to recover costs incurred in recovering payment for the mortgagor. Thus, claims for costs were usually be recovered with the mortgage debt and will rank in priority with the mortgage debt. The question which now arises is whether orders for payment of costs are made against other parties in circumstances where there are a number or competing claimants to a fund and the fund is not large enough to pay all the claims made upon it... A party should not, as a general rule, be entitled to recover costs from those who have held to have an interest ranking in priority after him. That accords with ordinary principles of fairness and equity... The parties will thus recover costs to the extent that they succeed in establishing the respective claims for priority and to the extent to which the fund is sufficient to pay the respective claims upon it.

When, however, a person brings a fund into being through the incurring of costs, other persons wishing to take the benefit of that fund must acknowledge any incontrovertible benefit conferred on them by the creator of the fund having incurred the costs in question, and in such circumstances equity will allow the person incurring the costs to enjoy a priority to the extent of the costs over the interests of other interest-holders, even if those other interest-holders would normally enjoy priority: see for example *Shirlaw v Taylor*¹⁵⁶; *Dean-Willcocks v Nothintoohard Pty Ltd*¹⁵⁷. This principle applies in relation to the costs of sale of mortgaged property: see *In Re Oriental Hotels Company; Perry v Oriental Hotels Company*¹⁵⁸; *Batten v Wedgewood Coal and Iron Company*¹⁵⁹.

It follows that a second mortgagee selling land will be able to recover its costs of sale of land in priority to monies owed to the first mortgagee, at least to the extent that the

¹⁵⁵ (1998) 72 SASR 210

¹⁵⁶ (1991) 31 FCR 222

¹⁵⁷ [2005] NSWSC 357

¹⁵⁸ (1871) LR 12 Eq 126

¹⁵⁹ (1885) 28 Ch D 317

sale of the land by the second mortgagee has save the first mortgagee costs by obviating the need for the first mortgagee to sell.

As stated above, second mortgagee will only be entitled to claim costs in priority to the first mortgagee to the extent that the first mortgagee has been saved costs as a result of the second mortgagee's actions. Thus to the extent that the second mortgagee, who is claiming the costs of sale of the security, has incurred costs over an above the costs the first mortgagee may have incurred to undertake the same sale, the second mortgagee will not be entitled to priority with respect to those additional costs. In such cases it is for the second mortgagee to show the extent of the "incontrovertible benefit" conferred upon the first mortgagee by the second mortgagee's actions. The second mortgagee is thus likely to obtain the reasonable costs of advertisement and auction of the security, but the second mortgagee's costs of litigation against the mortgagor is unlikely to enjoy priority as it will be difficult to demonstrate that the first mortgagee would necessarily have had to engage in that same litigation at the same or greater cost in order to cause the security to be sold.

5. Payment into Court

The mortgagee should pay surplus proceeds of sale in either of the following cases:

1. If there are several parties asserting that they are entitled to receipt of the surplus funds, those parties are unable to agree how the funds should be paid by the mortgagee, and the mortgagee is not able to determine which person has the superior claim. In this instance the mortgagee is a trustee who has a reasonable doubt as to the identity of the beneficiary or beneficiaries entitled to the trust fund (being the surplus funds), and in this circumstance the mortgagee may pay the surplus funds into the Supreme Court, whereupon the competing claimants may then commence proceedings in the Court for determination as to who is entitled to the funds.
2. If the mortgagee knows who should receive the funds, but is unable to pay the funds to that person so as to receive a discharge of the mortgagee's obligation to the person in question, then the mortgagee may receive a good discharge by paying the funds to the Supreme Court. This situation is less common than the first scenario, but may arise when the person entitled to the funds cannot be located, is deceased but no executor or administrator has been appointed, or has a legal incapacity such as being insane or being a minor.

Section 95 of the Trustee Act 1925 provides a general power to trustees to pay monies into the Supreme Court. Section 96 of that Act specifically enables a trustee to pay money into Court when the beneficiary is of unsound mind or a minor. Section 98(2) of the Act provides that a receipt from the Registrar of the Court will constitute a discharge of the mortgagee's liability to pay the monies.

Section 171 of the Conveyancing Act also provides that "Payment of money into court under the provisions of this or any other Act shall effectually exonerate therefrom the person making the payment."

The procedure for a trustee wishing to pay monies into court under the Trustee Act is prescribed by Division 4 of Part 70 of the Supreme Court Rules (one of the few parts surviving the Civil Procedure Act). SCR Pt 70 r 11 provides that if the person paying into Court wishes to obtain any order in relation to the funds paid in, the payment in should be by way of summons, which summons does not normally name any defendant. SCR Pt 70 r 12 allows monies to be paid into Court without commencing proceedings, and this would be the method by which a mortgagee would normally make a payment into court as the mortgagee normally does not seek any orders, but merely wants to obtain a good discharge for the funds.

Whether the payment is pursuant to Rule 11 or 12, the payment must be accompanied by an affidavit under Rule 13, which provides as follows:

- (1) A person paying funds into Court shall file an affidavit in accordance with this rule.
- (2) The affidavit must be made by the person paying the funds into Court or, if that person is a corporation, by an officer of the corporation.
- (3) The affidavit shall set out:
 - (a) a short description of the trust and of the instrument creating it or, as the case may be, of the circumstances in which the trust arose,
 - (b) the amount and description of the funds,
 - (c) the names and addresses, so far as known to the person paying the funds into Court, of the person interested in or entitled to the funds,
 - (d) where any person interested in or entitled to the funds is a minor, the name and address, so far as known to the person paying the funds into Court, of a parent or guardian of his person or estate or, failing these, of a person with whom he resides or in whose care he is,
 - (e) where any person interested in or entitled to the funds, is an incompetent person, the name and address, so far as known to the person paying the funds into Court, of his curator (if any) or, if he has no curator, of a person with whom he resides or in whose care he is,
 - (f) the name of the person paying the funds into Court and his address for service.

The payer into Court must then, under Rule 14, post a notice within 1 day of payment into Court to each person set out Rule 13 (c) (d) and (e).

Rule 15 requires the person paying the funds into Court “to answer all such inquiries relating to the application of the funds as the Court may make or direct”. Otherwise, the mortgagee need do nothing more.

If the mortgagee improperly pays monies into the Court, the mortgagee may be ordered to pay the costs of obtaining an order for the payment out of court of those monies to the person entitled to the monies in question.

Payment into court is justified when either there is a reasonable doubt as to who is entitled to the surplus monies, or the beneficiary is known but obtaining a good discharge from the beneficiary is impossible for some reason. If there is no real doubt as to the proper beneficiary of the surplus and the beneficiary can be located and is not legally incapable, then the mortgagee is not justified in paying the surplus into court, even if payment of money into court is for some reason convenient to the mortgagee.

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