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MORTGAGEES IN POSSESSION VERSUS RECEIVERSHIPS

JOHN SPARK

Ferrier Hodgson & Co.  
Chartered Accountants, Melbourne

**PREAMBLE**

A secured creditor with the capacity to appoint a receiver, and indeed an insolvent company itself, may have a choice between a traditional insolvency administration such as receivership, or something less traditional, eg. for the mortgagee merely to take possession, or to appoint an agent to do so.

Less traditional appointments have become somewhat fashionable, and these days are known as **creative** or **strategic** appointments.

For what purpose?

The prime justifiable motivation would seem to be avoidance of priority of repayment to the Taxation Commissioner under s 221P of the Australian *Income Tax Assessment Act*. The Commissioner gets priority where an employer has deducted tax from wage and salaries but not remitted such deductions to the Commissioner.

A number of other reasons are put forward for the mortgagee in possession (MIP) as against the receiver, and we will canvass these.

They include:

- publicity
- statutory obligations on receiver
- employee priorities
- liabilities or duties of care.

We shall assume that the receiver also has power to manage the company's affairs.

We shall also confine our comparisons to privately appointed (ie. non-court) receivers.

**GENERAL PURPOSE**

Protection, management and, where necessary, sale in order to protect the legal or equitable interest of the mortgagee.

While the receiver has additional responsibilities toward the company they should not interfere with the prime purpose of repaying the mortgagee.

Unless the mortgagee is a natural person, in taking possession he must of necessity act through employees or agents. Even if he is a natural person he may still choose to use employees or agents.

#### LEGAL STATUS OF APPOINTEE

The receiver is usually an agent of the debtor corporation by express term of the debenture.

A privately appointed receiver and manager is an officer of the company (s 5 *Companies Code*).

Even a court appointed receiver is an officer of the company for purposes of statutory duties of care (s 229). These are statutory duties of reasonable care and diligence (see sub-heading below).

It is at least arguable that an agent of the mortgagee who enters into possession or assumes control of company property to enforce a charge might also be caught by s 229 (see sub-s 5(b); cf. ss 234(1) and (2)).

#### QUALIFICATIONS

A receiver must be a registered liquidator, and cannot be:

- (a) a mortgagee of any property of the company
- (b) an auditor or officer of the company
- (c) an officer of any corporation that is a mortgagee of any property of the company (s 323(1)).

No such disqualifications apply to a mortgagee or his agent.

#### POWERS OF APPOINTEE

The powers of a privately appointed receiver stem from the debenture under which he acts and the document of his appointment.

Section 324A of the *Companies Code* also makes available a range of powers to the receiver. They are modelled upon those available to a liquidator, and consequently are extensive.

They apply whenever: *Necessary or convenient to be done for or in connection with, or as incidental to, the attainment of the objectives for which [the receiver] was appointed.*

The receiver has those powers: *In addition to any powers conferred on him by [the court order] or instrument, as the case may be, or by any other law, power, for the purpose of attaining the objectives for which he was appointed.*

Those supplementary powers under the Code are not available from that source to a mortgagee or his agent.

A receiver will not normally experience difficulty in passing title to the mortgagor's property to a potential buyer. The receiver can apply the company seal.

By contrast, a mortgagee in possession might experience difficulty unless there is an irrevocable power of attorney clause in the debenture appointing the mortgagee/agent as the mortgagor's attorney.

#### SECTION 221P

*Control* must pass to a trustee who has recourse to assets.

A receiver is a trustee. We will assume he has recourse to assets.

But unless he has some form of general control over all the company's assets (notwithstanding the existence of independent securities) *control* in the relevant sense does not pass to him (*Barnes* case).

If a receiver is appointed only to individual assets or to part of the company's assets, it seems he does not have *control*.

The mortgagee himself, or an agent appointed by him, is not a trustee under s 221P (*General Credits Ltd v Chemineer Nominees*).

Clearly, either the appointment of a partial receiver or the MIP route will avoid s 221P.

#### WAGE EARNER PRIORITIES

These are applied by s 331 of the Code.

Whether they apply depends largely upon whether a floating charge is being enforced. If it is, then the priorities will apply against a receiver of any kind, and against the debenture holder, mortgagee or his agent.

The effect is neutral between the alternatives of receivership or MIP.

#### LIABILITY FOR DEBTS INCURRED

Any receiver is personally liable under s 324 for debts incurred by him in the course of receivership, possession or control, for services rendered, goods purchased or property hired, leased, used or occupied.

The MIP would be personally liable as principal for any debts incurred by him by realising his security, or for any debts incurred by his agent.

The agent may himself arguably be liable under s 324 as a person who is enforcing a charge.

#### PUBLICITY ON COMPANY DOCUMENTS

A receiver must publicise the fact that he has been appointed on business letters, invoices, orders for goods and services, cheques and negotiable instruments. Penalty for non-compliance is \$1000 (s 327).

Not so a mortgagee or his agent.

#### STATUTORY RETURNS AND REPORTS

A receiver of any kind must obtain a report as to affairs from directors (s 328), submit 6 monthly accounts of receipts and payments to the Corporate Affairs Commission (s 330), and is otherwise subject to statutory supervision under the Code.

Not so a mortgagee or his agent.

#### DUTY OF CARE WHEN REALISING PROPERTY

Statutory duties under s 229 have been mentioned above.

Those statutory duties are:

1. To act at all times honestly in the exercise of the officer's powers and the discharge of the duties of his office.
2. To at all times exercise a reasonable degree of care and diligence in the exercise of his powers in this discharge of his duties.
3. Not to make improper use of information acquired by virtue of his position to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the corporation.
4. Not to make improper use of his position as an officer to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the corporation.

The Australian Law Reform Commission doubts that s 229 extends the duties of a receiver. As it refers to the officers *duties*, it seems to leave it open for the general law to continue to determine what those duties actually are.

Under the general law a receiver has a clear duty to act bona fide and not to recklessly sacrifice the mortgagor company's interests. A receiver who exercises his power negligently does not necessarily breach a duty framed in this way.

The general law duties of a receiver equate to that of a mortgagee or his agent.

The English position does make a receiver [mortgagee] responsible for negligence per se.

The Australian Law Reform Commission has pointed out that there are theoretical difficulties with this English line of authority. It has been criticised in Australia for equating the common law action for negligence with the equitable duty which a mortgagee has in exercising a power of sale.

The Commission recommends that there should be legislation for a duty requiring receivers to take reasonable care in the exercise of their powers, and that this should extend also to chargees who take possession and their agents.

Conveyancing/real property legislation in Victoria and Queensland impose a statutory duty on mortgagees (not expressly receivers) to exercise reasonable care in the sale of secured property to obtain a proper price.

#### FINANCIAL EXPOSURE OF MORTGAGEE/RECEIVER/AGENT

The appointment of a receiver enables the debenture holder to avoid personal liability, the receiver being the company's agent. Additionally the mortgagee is not responsible for the receiver's negligence, the receiver not being his agent.

Balancing that, the receiver will normally require an indemnity, but the mortgagee is still one step removed from creditors incurred by the receiver.

Claims by customers of the company in financial difficulty for breach of contract (eg. breach of warranty, product liability claims) or for civil wrongs or statutory wrongs giving rise to damages (eg. misrepresentation, unfair trading) will almost certainly be claims against the company in a receivership, the receiver being its agent. But in the case of an MIP, sales after appointment are more likely to give rise to liability from the mortgagee.

#### ORDER OF DISTRIBUTION

receiver and manager with control	partial receiver (to extent charge is fixed)	partial receiver (to extent charge is floating)	mortgagee in possession or mortgagee's agent
1. Commissioner of Taxation (221P)	1. receiver	1. receiver	1. wage earners (ex-floating charge assets)
2. receiver	2. mortgagee	2. wage earners	2. mortgagee and agent
3. wage earners		3. mortgagee	
4. mortgagee			

**CONCLUSION**

The choice between an MIP and a receivership must depend on the circumstances of each case.

Clearly there will be factual situations where group tax is to be avoided or the absence of publicity seen to be valuable.

But group tax may also be avoided by the appointment of a partial receiver, without going to the extent of a mortgagee administration.

The financial exposure of the mortgagee and his agent may ultimately determine the best administration. The avoidance of personal liability for the mortgagee, particularly in areas where contracts must be renegotiated and numerous liabilities incurred will often be a deterrent to the MIP route.