MORTGAGEES IN POSSESSION VERSUS RECEIVERSHIPS

QUESTIONS AND ANSWERS

Question - John Karkar QC:

Could I just ask whether an ingredient of the cause of action for inducing breach of contract is an intention of the inducer to injure the contracting party? If it is, then it will make it less likely a successful kind of cause of action against an agent in possession.

Response - Cathy Walter:

I don't think it is necessary. In terms of the attributes that were extracted in that *Edwin Hill* case - the five attributes were a direct interference, the interferer had knowledge of the contractual relations, the interference was intentional, the third party suffered damage and interference was not justified.

Question - Ian Gray (Holmans, Brisbane):

My question relates to the financial exposure of mortgagees in possession. Most of what we have heard today focuses on the actions of the mortgagee in possession or the agent once they have actually got into possession. The question I would like to ask is about partly completed contracts that have been entered into by the company/mortgagor itself and the mortgagee in possession seeks to adopt the benefit of those contracts. By adopting the benefit do you also adopt the burden for the liabilities of those contracts including pre-existing liabilities such as liability for defective workmanship, and product liability? I think there is scope in the area of manufacture in the construction and building industries for fairly heavy liabilities there.

Response - Cathy Walter:

I think that there is a very real risk that if you do adopt it without making any special arrangements for the other party to the contract that those things that you describe will flow. I think there is an opportunity perhaps for a novation whereby you might create some new contractual relationship which seeks to make some compromise in respect of pre-existing liability.

Question - Peter Fox (Mallesons Stephen Jaques, Melbourne):

This is really a genuine question which may just display my lack of reading or missing something. We fully understand under a floating charge how one confers powers on management on a receiver. I am having some difficulty in grasping how under a floating charge one confers powers of management on a mortgagee.

Response - Cathy Walter:

In a well-drawn mortgage, such as no doubt characterise those of your firm Peter and hopefully of ours, it is frequently the case that a mortgagee in possession is given the same powers that are given by a receiver both under the debenture itself and also the mortgagee in possession should he so go into possession. He is given all the statutory powers that might be given to the receiver. That can be done by specific drafting and it is very frequently done in sophisticated debentures. If it is not done, your question is much harder.

Question - Lindsay Powers (Minter Ellison, Sydney):

My question is directed to Cathy Walter. In relation to your argument concerning the application of s 299 to mortgagees in possession or their agents, given that there is that express reference to a person who enters into possession of assets the subject of a charge in s 229, who do you think that the legislators had in mind when they drafted that express provision in s 229(5)?

Response - Cathy Walter:

I get alarmed when a person who asks the question stays by a microphone for fear there is going to be a whole volley of them. Thanks for that question Lindsay. It is actually very interesting. After I got back from the dinner last night I started to think about that very issue which is probably just as well bearing in mind I have now just scored a question on it. You are right that s 229(5)(b) does refer to an agent who so goes into possession. I have the view that it may be that that has the effect of potentially including within the class of officers such agents. But then if you go back through the argument that I have given you that ss 229(1), (3) and (4) in particular make it quite clear that they refer to duties or position or info or whatever relating to an office held in respect of the company - that agent for the mortgagee in possession although prima facie included within the section would not satisfy the office test because he doesn't hold an office in relation to the company. I am on shakier ground I am happy to confess with respect to s 229(2) in respect of the reasonable care and diligence obligation because it doesn't specifically import an office and if I were really pressed in relation to that, I might say that perhaps there is a situation where if an agent goes in as agent for the mortgagee in possession in respect of all of the assets of the chargor, then you can nail him under s 229(2) because I think the

words in s 229(5)(b) make it clear that it is an agent in possession of the whole of the assets. It is a bit of a parallel with that s 221P argument, but if he goes into possession of perhaps part only of the assets then maybe s 229(5)(b) doesn't catch him and he falls outside s 229(2). But I have greatest difficulty with the argument on s 229(2). Thank you for raising it.

Question - John Karkar:

I don't understand you to suggest Cathy that an agent in possession may well be an officer for the purposes of sub-section (2) but not for the purposes of sub-ss (1), (3) and (4)? He has got to be an officer for all purposes.

Response - Cathy Walter:

Lindsay indicated to me that the definition of officer in s 229(5)(b) includes an agent for a mortgagee in possession. So prima facie he is an officer for the whole of the section, that's right. But the duties imposed under ss 229(1), (3) and (4) use quite specific language. They speak of duties of his office or in respect of the position for (3) and (4), and that imported to my mind and that being the thrust of my argument, that those sections are only applicable to persons who hold an office in respect of the company, not just prima facie officers who have been included within the definition under s 229(5)(b).

Martin Kriewaldt (Feez Ruthning, Brisbane):

Sorry Cathy, this is another question for you. If you adopt the position that the mortgagee in possession, the agent, is in fact an officer of the company, don't you then wind up with a real problem under s 229(3) which includes not only the information for that particular agent, but also for anyone else, and the agent will certainly be giving the information back to the appointing bank?

Response - Cathy Walter:

Yes, it is an interesting question Martin. I would slickly avoid that by saying that s 229(3) does not apply to such an agent for a mortgagee in possession for the reasons contained in the thesis which is to say that such an agent does not hold an office in respect of the company.

Can I just address, because I might get no other chance and it is much better fun asking yourself questions I have discovered this now, the question of how an agent for a mortgagee in possession might enter into contracts, because I think that is important in the context of some of the issues John raised. Very frequently mortgage debentures will have a power of attorney given to the mortgagee such that the mortgagee may enter and indeed any agent of the mortgagee may enter into contracts in the name of the mortgagor. Where they do have such provision I think that would overcome the problem that John mentioned.

Comment - Peter Hedge (Coopers Lybrand, Sydney):

My comments are more by way of an observation in support of John than as a question because I think it is worth noting that certainly agents for the mortgagees attract a lot of attention in more recent years since the *Chemineer Nominees* decision driven by the group tax issue. But it certainly is not a new concept and has been around for as long as mortgagees have been around. And I think that is an important point because there is a general feeling, certainly amongst banks, that it is all a new whiz-bang approach, and obviously it is important from the legal perspective that we make it clear to the banks that it is just merely another option that has always been there.

I think the problems that have arisen have been because people have used it as a mechanism to avoid group tax rather than as a proper enforcement mechanism that is suitable in certain circumstances. And perhaps in criticism of our profession as well there are many administrators who have run off without fully understanding what their roles have been - obviously the bank has not known and the solicitor involved has not necessarily checked them and as such I think it leaves a number of agents for the mortgagees exposed as John is elucidating to the forum - for action from the group tax or the Corporate Affairs Commission. I think it has been very important to have discussed the issues because finally everybody is now aware of what is involved and can go back and advise their client on a more informed basis in order to improve the outcome rather than merely look at taking possession as agent because that is the trendy thing to do.

Response - John Spark:

If I can just make a quick comment on that. If you have a doctrine which says you can go in under both, whether as an agent or a receiver, even if you go in as an agent, I would think three times about all of the other issues which actually come home to roost. Because really there are a lot of things outside the doctrine which affect the appointment and I think a lot of administrators are not thinking that way. They are thinking that they are the same thing. They are not.

Question - Kevin Dundo - (Robinson Cox, Perth):

Talking about offences - has the Panel considered the situation of a bank being given advice prior to an appointment that there is a group tax problem and then proceeds to appoint an agent, as to whether or not that action is an offence under the *Crimes (Taxation Offences) Act* in aiding and abetting - an offence in avoiding the payment of the group tax?

Response - John Spark:

One comment I could make - there is certainly one bank present that does not appoint agents for the mortgagee for lots of reasons, and I think that is one of them.

Response - Cathy Walter:

Learned counsel next to me says he thinks the answer is no, and that will do me!

Question - Hugh Chalmers (Cutler Hughes & Harris, Sydney):

Just on your point about drafting. I have seen those documents you are talking about and in fact ours is very similar, but the worry that I always have in the back of my mind is that you have a voluminous set of powers attributed to the receiver, you then have the clause saying "if we call him or effectively substitute the word 'agent' for receiver in the previous clause" I am always just a little nervous that a court will look through that and perhaps say "what are you really doing? Is this man a receiver? Are you just playing with words?" - and I just wonder whether John Karkar might have, or any of you might have a comment on that?

Response - John Karkar QC:

I think you have got to look at the document appointing and that primarily will give you the source of powers and the nature and character of the appointment.

Response - Cathy Walter:

We in fact had in the office recently I think an unreported case involving Partnership Pacific in which there was perhaps on one view, perhaps not really, an ambivalent appointment deed. There was further reference had to the whole way in which the parties had treated the agent, mainly as to whether he was intended to be a mortgagee in possession or a receiver. And that assisted the court in deciding that in fact the appointed accountant was an agent for the mortgagee in possession.

Question - Jonathan Flaws (Bell Gully Buddle Weir, Auckland):

An observation and in fact two questions. The observation is that in New Zealand we don't have a group tax problem, so we have never really addressed the question of going in as mortgagee in possession. The income tax TST and land tax position in New Zealand would be such that you would not even contemplate it because you are for all intents and purposes a mortgagor. The first question deals with the equitable liability to account for what you actually receive and what but for your wilful neglect you might have received. It seems to me that in a passive possession where you are dealing with a piece of land which has got ascertainable income it is quite easy to see how wilful neglect is a pretty strong test; but where you are going into possession of the assets of the company and the agent actually starts to make a loss, I wonder whether the loss, making any loss would be sheeted home to the mortgagee? And the second question was that you haven't considered one real difference between a receiver and a mortgagee in possession. And that is a receiver

can go into possession and can be taken out of possession or out of receivership quite easily. But as I understand it once a mortgagee is in possession you cannot go out of possession until you are either repaid or you give up your security.

Response - Cathy Walter:

We have had a division of labour here and I am doing the first question and John the second.

On that question of rent that might have been received but wasn't - it is useful to bear in mind in that context the obligation which a mortgagee has and I forget the precise words but not to involve the mortgagor in additional expense which had it been expended might have produced significant additional income. He really more or less has only the obligation to realise the property as it stands. For example, if the units are not strata titled and only producing x, but if strata titled would produce y, the mortgagee shouldn't in fact incur expenditure to increase the level of rental if it is not reasonable in terms of the overall mortgage liability. So I think that is a good counter-point to the obligation to account for what might have been received.

Response - John Spark:

One comment I would make - most of the property situations in Victoria at the moment are very active. They may be city buildings, shopping centres or city building that need to be finished and let. So I think the point there is there is a great possibility where receivers can be criticised for not doing the right thing in what is in fact a very active property market in a funny sense, certainly in Victoria, because there are so many things to be done to these properties to get them to a saleable stage or in fact to maintain the income streams.

Response - Cathy Walter:

The second question bounced back to me when I wasn't even looking. It is difficult if you go into possession. You have sort of got possession and short of having someone else take it back from you, I do have difficulty with the notion as to how you might go out of possession short of realising your security or as you said in the absence of that just releasing it which would be pretty undesirable. But I would be most interested as to whether anyone in the audience had a response to that.

Comment - John Karkar QC:

Unless you provide specifically for it in the mortgage.

Response - Cathy Walter:

But you would have to sort of deem the mortgagor to be retaking possession the second you gave a little bit of a nudge and said, hey I'm sick of it sort of routine.

Comment - Jim O'Donovan (Baker & McKenzie, Melbourne):

There is a case where a receiver replaced a mortgagee in possession. So that would be a useful way of terminating the possession by the mortgagee.

Response - Cathy Walter:

Then the receiver could - excellent, great, thank you.

Comment - Erica Simes (Chairperson):

Well that concludes this morning's session. Could you join me in thanking our panel.