Corporate Insolvency and Restructuring Practice Group Forum

Receivers' Power of Sale

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The precise nature of a corporate receiver's obligation when selling assets has long been a bone of contention in Australian law. Essentially, the scope of that dispute has involved a line of English authority suggesting that the nature of the duty was, as most commonly expressed:

A mortgagee [read also corporate receiver] when exercising a power of sale owes a duty to the mortgagor to take reasonable care to obtain a proper price for the true market value of the property. ²

The English line of authority equates the duty with the common law concept of negligence and has the effect that a mortgagor would have a cause of action in tort against a negligent mortgagee or receiver.

That position is to be contrasted with the Australian line of authority which recognises the inherent conflict between the interests of unsecured creditors and shareholders with the interest of the secured creditor. The Australian authorities have eschewed the English position of a common law duty on mortgagees and receivers, preferring to impose a less stringent equitable duty of "good faith". Thus the nature of the duty in Australia was commonly described as a duty to exercise the receiver's powers in good faith to serve the objectives of his or her appointment and not recklessly sacrifice the interests of the company ³.

The introduction of section 420A of the Corporations Act appeared to have resolved that debate. Section 420A requires that when exercising a power of sale in respect of corporate property, a receiver must take all reasonable care to sell the property for its market value or, if there is no market value, the best price that is reasonably obtainable.

Appearances, however, can be deceiving and it appears that the scope of a receiver's duty, even with the imposition of the duty in section 420A, remains far from clear. The scope of section 420A has been the subject of 2 recent Australian decisions:

- Ultimate Property Group Pty Ltd v Lord (2004) 22 ACLC 423 (Ultimate Property)
- Florgale Uniforms Pty Ltd v NAB Ltd (2004) 22 ACLC 1, 580 (Florgale)

Section 420A(1) of the Corporations Act 2001 (Cth) provides that:

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¹ With thanks to Joanne Little for her summary of Florgale and to Belinda Hollway for her editorial suggestions and analysis of the Endormer, MESK and GE Capital decisions

² Cuckmere Brick Co Ltd v Mutual Finance Ltd [1971] Ch 949.

³ Expo International Pty Ltd (Receps/Mgrs Apptd)(In Liq) & Anor v Chant & Ors (1979) 2 NSWLR 820 at p824.
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 was sold.

The section only applies to a "controller" and that under section 9 of the Act a controller, in relation to property of a corporation, means:

1. a receiver, or receiver and manager, of that property; or

2. 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.

Importantly, this means that the section applies to receivers, receivers and managers and mortgagees in possession but it does not apply to voluntary administrators. This is so whether the voluntary administrator is appointed by a resolution of the company's directors or by a secured creditor with an enforceable charge over the whole or substantially the whole of the company's assets. In both cases, the voluntary administrator's role post-appointment is identical – even when appointed by a chargeholder the voluntary administrator is in possession or has control of the property of the company in administration for the purposes of Part 5.3A and not for the purpose of enforcing a charge.

The fact that section 420A does not apply to an administrator can be an important issue for a secured creditor to take into account in deciding whether to appoint a receiver – who (subject to the Court's findings in Florgale which I'll come to) will be duty bound to comply with the specific statutory requirements of section 420A which may take time and cost money as compared with the duties of a voluntary administrator in exercising a power of sale. There is no equivalent of section 420A in Part 5.3A and this makes sense – an administrator (however appointed) once appointed must act in the interests of all of the creditors of the company. In contrast, a receiver is appointed by a secured creditor with the role of realising assets to pay off the secured debt – so it makes sense for there to be a statutory overlay to keep the receiver honest, ie to ensure that the receiver does not sell assets at a discount simply to recover the secured debt quickly and cheaply but to the disadvantage of other creditors and the borrower itself.

If a secured creditor was looking at appointment options to a borrower without assets of very substantial value or to a borrower where the value lay in sale of the business as a going concern, appointment of an administrator (who might in the circumstances be able to sell the assets or business quickly and without going to auction or obtaining detailed professional independent valuations) might be a better option to appointing a receiver bound by section 420A.

For receivers, complying with section 420A was particularly an issue where the relevant assets had a market value because on a literal reading section 420A(1)(a) imposed a duty to obtain "market value": the receiver could see the value of the asset diminish and unnecessary costs incurred in ascertaining the market value to the detriment of both the mortgagor and the mortgagee.

The problem was exacerbated by a tick the box or process driven approach by Courts exemplified by the comments of Campbell J in Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd (2002) 10 BPR 19, 565 (Artistic Builders) in which Campbell J said:
In deciding whether there has been a breach of s420A, a Court looks at the process that a controller of property of a Corporation has gone through in selling that property. The inquiry is whether, in the course of that process, the controller has taken all reasonable care to sell the property for not less than its market value. It is not necessary to prove that the property was in fact sold for less than its market value – a controller could breach s420A, but, through luck, still manage to sell the property for its market value or more. Further, it is not necessary for me to find what actually was the market value of the property, to be able to find that s420A(1)(a) was breached – all that I need find is that the process gone through was not one where all reasonable care was taken to sell the property for its market value, whatever that market value might be.

The problem is further complicated by the existence of some cases in which the Courts do not appear to have recognised the complexity of the relationship of s420A(1)(a) and (b). For example, in both Endormer Pty Ltd v Australian Guarantee Corporation Ltd [2000] FCA 1669 (Endormer) and Commonwealth Bank of Australia v Milder Elfman Szmerling Krycer Pty (unreported Supreme Court of Victoria per Hansen J 18 February 1998) (MESK), the Courts have referred to s420A(1) as imposing a requirement on a controller to take all reasonable care to sell the property for its market value or alternatively for the best price that was reasonably obtainable when the property was sold. These cases, presumably due to the way they were pleaded and argued, appear to treat the two options in s420A(1)(a) and (b) as simultaneously available alternatives, rather than the second alternative being available only where the property has no market value. In both cases the Court upheld sales conducted in a very short period of time when no independent valuation had been obtained, without any analysis of s420A(1), the relationship of the two paragraphs or the relevant case law. These cases are considered in more detail below.

The two recent cases that are considered in this paper demonstrate that there remains real uncertainty as to the receiver's duties at common law and in equity in exercising the power of sale, even when the legislative provisions and previous case law is analysed in detail.

In Ultimate Property, Young CJ was critical of Campbell J's comments in Artistic Builders which are set out above.

The Florgale decision if followed by other courts is a very helpful and practical decision for bankers and receivers and may reduce the anxiety which both might have about section 420A, particularly in circumstances where the cost of obtaining market value and of trading a business on whilst that occurs are not commercial. It may bring receivers back into the picture as an option where the appointor is after a quick sale following appointment.

As is discussed in more detail below, in Florgale the Court found that a receiver was not necessarily bound to find out and obtain the market value where the relevant goods had one – if the associated costs and risks were such that they would make going through the process unreasonable the receiver did not breach section 420A by not doing so. The facts in Florgale were somewhat unusual so it remains to be seen how far this approach will be followed.

In relation to a receiver's duty under s420A of the Corporations Act 2001 (Cth) in exercising a power of sale, in particular we concentrate on whether these cases provide authority for the proposition that a receiver does not have to take steps to determine the market value of property and then sell property for no less than the market value where to do so would be unduly expensive or difficult. Before turning to consider the Ultimate Property and Florgale decisions in detail, we will
first set the scene with a more detailed examination of the relevant aspects of the decisions in
_Endormer, MESK and GE Capital Australia v Davis (2002) 180 FLR 250 (GE Capital)._ 

1. **Endormer, MESK and GE Capital in summary**

_Endormer and MESK_ do not discuss either the legislation or the case law in any detail. They simply
refer to the test in s420A as a requirement that the receiver sell the property for market value or the
best price reasonably obtainable in the circumstances. The Court in both cases appeared to
regard these as simultaneously available alternatives, rather than the second alternative as
available only where the property has no market value. Both cases turn on their facts and there is
no attempt in either case to analyse s420A(1) and the relationship of the two paragraphs. In both
cases the court upheld sales in a very short period of time when no independent valuation had
been obtained.

_GE Capital_ discusses the relationship of s420A(1)(a) and (b) and concludes that s420A(i)(b) only
applies where it is not possible to determine the market value. The certainty with which market
value can be determined is a continuum from considerable certainty (eg shares) through to very
little certainty, and at some point there is so little certainty that for the purposes of the provision
property can be said to have no market value and s420A(1)(b) therefore applies.

Accordingly, these cases do not provide authority for the proposition that a receiver does not have
to take steps to determine the market value of property and then sell property for no less than the
market value where to do so would be unduly expensive or difficult.

However, _GE Capital_ is authority for the proposition that where the difficulty of determining market
value reaches a certain (unspecified) point, this difficulty means that for the purposes of s420A(1)
there is no market value. _Endormer and MESK_ demonstrate that the court will support expedient
sales in certain circumstances where no valuation is obtained, but the lack of consideration of the
relevant provisions make them of limited precedential value.

2. **Endormer Pty Ltd v Australian Guarantee Corporation Ltd [2000] FCA 1669**

2.1 **Background**

_Endormer Pty Limited (Endormer)_ conducted a business as a new and used car dealer at
various locations throughout Sydney. Endomer borrowed money from the Australian
Guarantee Corporation Limited (AGC) and AGC obtained a charge over Endomer's
assets. AGC subsequently appointed a receiver pursuant to the deed of charge and the
receiver collected and disposed of Endomer's assets.

Endomer and other applicants brought an action against AGC, the receiver and others,
claiming that the relevant security was void or should be avoided and that AGC was liable
to pay damages in excess of any alleged shortfall. AGC cross-claimed on the grounds that
there was still a substantial balance owing.

Endomer made four sets of claims:
(a) misleading and deceptive conduct by AGC in inducing Endomer to enter the loan contract;
(b) negligent administration of the loan contract by AGC;
(c) invalidity of the deed of charge and the appointment of the receiver; and
(d) claims against the receiver relating to the alleged invalidity of the deed and the receiver's appointment and to the manner in which the assets were disposed.

Justice Gyles rejected the claims of negligence and of misleading and deceptive conduct by AGC. His Honour also rejected the argument that the charge was invalid.

2.2 Conduct of the receiver

On 12 April 1994, Endormer resolved to appoint an administrator. On 13 April a provisional liquidator was appointed to Endormer on the application of the company, based on an affidavit of insolvency. At this time, the company was not a going concern. Justice Gyles noted that it had no cash in the bank; that it was in arrears in relation to leases; there was little stock on hand for sale; the franchisor informed the receiver that it was considering terminating the franchise; and each day the business continued to operate it incurred further liabilities, including to staff. His Honour stated that the receiver "had no alternative but to move urgently."

The receiver arranged a competitive tender from three bidders by 15 April. The bids varied, and the receiver chose the bid of Twamley Pty Limited (Twamley) on the evening of 15 April. The deal with Twamley was subsequently renegotiated after Twamley considered matters further, but Gyles J accepted that the receiver did not have to re-open the bidding process.

Twamley took certain assets and liabilities, agreed to assist in the collection of debts, took over all warranties and guarantees and continued the employment of some employees. No payment was made for goodwill.

In September 1995, approximately 18 months later, Twamley sold the company for a price which included $900,000 for goodwill, the logo and the business names. Endormer argued that this illustrated the improvidence of the transaction between Twamley and the receiver and that it was entered into with undue haste.

2.3 The decision

Justice Gyles set out the claim as follows:

The second claim is that the Receiver failed to take all reasonable care to sell the property of Endormer for its market value, or alternatively, the best price that was reasonably obtainable when the said property was sold.

This passage tends to suggest that his Honour regarded the test in s420 as simultaneously available alternatives, rather than the second alternative as available only where the property has no market value. However, there is no analysis in the judgment of s420A or the interrelationship between s420A(1)(a) and s420A(1)(b). There is no discussion of the case law.
Justice Gyles decided the case on the facts. His Honour accepted the receiver's argument that the arrangement with Twamley was the best that could be obtained in the circumstances. The subsequent sale of the business by Twamley simply demonstrated the difference made by 18 months of successful operation of that business and its sale as a going concern, rather than the sale of an insolvent business by the receiver.

After indicating his conclusions on the facts, his Honour simply stated:

I find that the Receiver did take all reasonable care in the circumstances in selling the assets in question, and that the best price that was reasonably obtainable, having regard to the circumstances at the time, was in fact obtained. I therefore reject the claim against the Receiver, whether it be based upon s420A of the Corporations Law or the general law, whatever may be the content of each…"

This decision turned entirely on the facts and contains no discussion of the applicable legal tests, either from the legislation or the case law. It may be seen as authority for the proposition that the Court will support an expedient transaction in appropriate circumstances, however, it is difficult to formulate any real test arising from the case.

One possible interpretation of the decision is that it is implicit in the judgment that if a business is not able to trade as a going concern due to insolvency, the business does not have a market value and s420A(1)(a) therefore does not apply. It should be stressed that there is little in the text of the judgment to indicate that this is the line of reasoning followed by the Court, however. In our view there is insufficient discussion of s420A or the case law for it to be regarded as valuable authority on the provision.

2.4 Appeal

An appeal was brought by one of the applicants, Mr Jarrett, who was self-represented at the appeal. The appeal was dismissed by the Full Federal Court (Lee, Finn and Conti JJ) *(Endormer Pty Ltd v Australian Guarantee Corporation [2001] FCA 1208)*. In considering the aspects of the appeal relating to the receiver, the Court essentially summarised the findings of Gyles J at first instance. The appeal decision therefore provides no further assistance on this point.


3.1 Background

This case involved a number of claims and cross-claims. The defendants were solicitors, the corporation Milder Elfman Szmerling Krycer Pty, under which the solicitors conducted their practice and a trustee company that provided administrative services (MESK and the trustee company together the corporate defendants). The relevant aspect of the case involved claims by the defendants against the applicant, the Commonwealth Bank (the bank).

The bank had appointed a receiver to the corporate defendants pursuant to the bank's power under debentures granted by the corporate respondents. The receiver took steps to
sell the solicitors practice, including by advertising the practice for sale by name in the newspaper and stating in the advertisement that the practice was subject to an administrator and receivers and managers. The advertisements first appeared on 8 June and stated that expressions of interest were sought by 12 June. 27 enquiries were made by interested persons and three put in responses to tender. A contract was entered into with the purchaser on 5 July.

The defendants alleged that the bank, its receivers and managers breached duties to the corporate defendants to exercise a reasonable degree of diligence in the exercise of their powers in the discharge of their duties to "take reasonable care to sell the property for not less than the market value or the best price reasonably obtainable, to act in good faith, and to act in the best interests" of the corporate defendants. These duties were said to arise by reason of s232 and s420A of the Corporations Law, common law and equity.

The defendants alleged a variety of misconduct by the receiver, including bad faith, a failure to consult the defendants, failure to obtain a valuation, failure to take reasonable steps to maximise the return of the realisation of assets, failure to allow sufficient time for expressions of interest, failure to consult a practice broker and failure to consider alternative courses of action. The defendants' alleged that the receiver should have made greater efforts to maintain the solicitors practice as a going concern, for example he should not have included the name of the practice in advertisements seeking to sell the practice, as this contributed to the practice's decline.

The receiver argued that it was necessary to sell the practice as quickly as possible, as the value of the practice was the value of the files it held, and that clients began to remove files once it was known that a receiver had been appointed.

Each side led expert evidence as to how the receiver should have gone about selling the business.

3.2 The decision

As with Endormer, the decision appears to turn almost entirely on the facts and there is no real discussion of the legislative provisions or the case law. Justice Hansen consistently preferred the evidence of the witnesses for the receiver to the evidence of witnesses for the defendants.

Justice Hansen noted that the corporate defendants were insolvent and that the individual who was appointed by the Court to run the solicitors practice, prior to the bank appointing the receiver, had already determined to close the practice quickly. In the circumstances, Hansen J stated that "The receiver was obliged by the Corporations Law to move speedily". His Honour rejected all the allegations made against the receiver by the defendants.

In relation to the allegation that the receiver had failed to obtain a valuation of the assets of the corporate defendants, including their goodwill, Hansen J stated:

I find that in the circumstances, which were circumstances of urgency and in which goodwill had no or little value, and in which clients were constantly removing files, the receivers and managers and Keogh took reasonable care to ascertain the assets and property of MESK and Taruba and the value thereof. … As far as goodwill is concerned the task was to keep
the practice going … and see what the market would offer; there had to be a sale and the market would provide the figure, if any, and there turned out to be none. [ie – no amount for goodwill was included in the eventual sale price]

*MESK*, like *Endormer*, is authority that the Courts will support an expedient sale in circumstances where delay is likely to further decrease the value of the business. However, again like *Endormer*, there is no analysis of what is required by s420A or the relationship between s420A(1)(a) and s420A(1)(b). The extract above suggests that Hansen J was content that the market value would be established by the very act of offering the business for sale.

4. **GE Capital Australia v Davis (2002) 180 FLR 250**

This case is discussed further below in relation to the comments made by the Court about the rights conferred on mortgagors or guarantors by s420A. Our discussion here is limited to the Court’s approach to the relationship of ss420A(1)(a) and (b).

4.1 The facts

This case involved the plaintiff suing four guarantors for $1 million. The borrowers, who were not parties to the proceeding, operated a fabric coating business. After the failure of the business, the plaintiff, GE Capital, exercised its powers pursuant to a fixed equitable charge to sell the plant and equipment. GE Capital then brought proceedings against the defendants, the four guarantors, for the amount that remained outstanding after taking into account the proceeds of this sale. The defendants cross-claimed, arguing among other things that the secured property was not properly realised when it was sold at auction.

4.2 Section 420A

Unlike the other two cases discussed above, Bryson J in this case discussed the relationship of s420A(1)(a) and (b) in some detail. His Honour had already decided the case on other issues, but gave his obiter conclusions on this issue as detailed submissions had been made on the subject.

Justice Bryson reviewed various other cases that had considered the relationship of the two paragraphs of s420(1). His Honour stated that:

> In my view, para (a) turns on whether the property has a market value, not on whether there is a market for the property… In my opinion which of paragraphs (a) and (b) is applicable depends on the degree of certainty with which value is ascertainable by reference to events in a market… and the language of sub420A(1) requires it to be understood that a degree of uncertainty can be reached at which there is not a market value and value is to be ascertained otherwise. Even for sales of small parcels of shares there can be price variations within a day or within an hour. Complete certainty is rare. It can reasonably be supposed that market events can yield ascertainable values, with the assistance of expertise and with receding certainty, for retail goods, new cars, second hand goods, used cars, rarely trade large parcels of shares, house properties; but it appears to me that, in the meaning of the words in the subsection, a point is reached where market experience does not yield a market value with sufficient certainty to be used as an integer. I cannot offer means by which to establish the exact point of transition out of market value…
His Honour went on to say that in this case, the main items in the production line of the business had such special characteristics of use, location, age, history and adaptation that they did not have a market value in the sense the term is used in s420A(1)(a). His Honour stated that the evidence led in an attempt to show market value by reference to sales or other dealings with property said to be comparable only succeeded in demonstrating the unavailability of any useful valuation reasoning based on comparable sales or otherwise based on market events.

Justice Bryson therefore considered that the appropriate test in this instance was whether the plaintiff took all reasonable care to sell the property for the best price that was reasonably obtainable. After a detailed review of the facts and the expert evidence, his Honour concluded that the plaintiff had taken sufficient care.

5. Ultimate Property Group Pty Ltd v Lord (2004) 22 ACLC 423

In Ultimate Property Group Pty Ltd v Lord (2004) 60 NSWLR 646 Young CJ found that:

(a) in exercising a power of sale, a mortgagee does not owe a common law duty to take reasonable care to obtain the true market value of the property;

(b) a mortgagee (or receiver) does, however, owe an equitable duty when selling property to act conscionably towards the mortgagor and persons under the mortgagor. When determining whether a mortgagee (or receiver) has breached this equitable obligation the whole of the conduct with respect of the sale should be considered. Mere inadequacy in the price obtained does not, of itself, demonstrate a breach of duty;

(c) a contravention of s420A of the Corporations Act gives rise to a private action for equitable damages equivalent to that available for breach of the equitable duty of a mortgagee to act conscionably.

The case is odd in a number of respects:

1. It has a lengthy and erudite discussion on the remedies available for breach of section 420A, concluding that equitable damages rather than common law damages were the appropriate form of relief.

2. The result appears to be that if the borrower owes a residue after a sale which contravenes section 420A, the borrower will have a claim for equitable damages. The equitable damages will be the amount the property should have been sold for and can be set off by the borrowers against the amount of the residual debt. It is not entirely clear from Young CJ’s decision whether that is the entire reach of relief, i.e. whether a borrower could recover loss suffered if the property was sold for a sum sufficient to exhaust its indebtedness in full but otherwise in breach of s420A.

All of this in circumstances where Young CJ found:

(i) that the plaintiffs’ claim should fail;
(ii) that the auction which brought about the sale was properly conducted after a professionally managed advertising campaign and brought a price of $1.35m;

(iii) $1.35m was the property's market value at the relevant time.

Given these findings, perhaps the balance of the case (other than the finding that the purely process driven approach of Artistic Builders should be rejected) should be considered to be obiter and not of binding precedential value.

Facts

Ultimate Property Group Pty Ltd mortgaged property to a Bank. A number of other parties acted as guarantors of the loan. The loan subsequently fell into arrears and the Bank appointed Mr Lord to act as controller of the mortgaged property.

Mr Lord subsequently sold the property at auction in circumstances which left a shortfall in the amount repaid to the Bank which the Bank then sought to recover from the guarantors. The guarantors counter-claimed that:

(a) the controller had made a critical error in valuing the property;
(b) the property should have been sold in a manner as to avoid a liability for GST; and
(c) the controller had therefore breached his general law duty and his statutory duty under s420A.

The evidence presented was that while the receiver had a copy of the flawed valuation he did not rely on it when considering the sale but rather relied on his own valuation and the marketing advice of a real estate agent. Based on the advice he had received and on his own research into comparable sales, Mr Lord placed a reserve on the property (which was significantly below the value attributed to the property in the flawed valuation report). The property sold at a price above the value estimated by the real estate agent but below the price which the flawed valuation should have valued the property but for a mistake in that report.

Duty at General Law

Justice Young examined the authorities into the nature of a mortgagee's duty under the general law when exercising their power of sale. His Honour noted the divergence in authority between the English authorities and the Australian authorities.

The English position is reflected in the Cuckmere Brick Co Ltd v Mutual Finance Ltd [1971] CH 949 decision in which it was said that a mortgagee, when exercising his power of sale, owed a duty to the mortgagor to take reasonable care to obtain a proper price or the true market value of the property. That test has not been followed in Australia which had preferred the test in Expo namely, that a mortgagee or receiver has a duty to exercise the receiver's powers in good faith to serve the objectives of his or her appointment and not recklessly sacrifice the interests of the Company which is a much less stringent equitable duty. After weighing the authorities, Young CJ concluded that there is no common law duty in negligence on a mortgagee in New South Wales which makes a mortgagee liable in common law damages if he or she fails to get a good price for the mortgaged property.

Justice Young's finding on that issue is at odds with the in Florgale decision which is discussed below in which Dodds-Streton J maintains that there is a general law duty owed and that an action
for the tort of negligence would be maintainable against a receiver in breach of the duty. The property sold for its market value of $1.35m.

**Equitable Duties**

Justice Young then considered what the nature of the equitable duty on mortgagees may be. Justice Young found that the receiver’s duty is a duty to act conscionably towards the mortgagor and persons under the mortgagor and that the duty is not to be considered in some mechanical way, but the whole of the mortgagees’ conduct with respect of the sale is to be considered. The mortgagee may, up to a point, act solely in its own interest, but it must also act conscionably toward the mortgagor and those claiming under the mortgagor.

*Gomez v State Bank of New South Wales* [2001] FCA 1059 was cited in support of that proposition in which Branson J had said that the borrower was “required to satisfy the Court that… the Bank so failed to take reasonable steps to obtain a proper price for the properties that it was guilty of unconscionable conduct. It will be insufficient for [the Borrower] to satisfy the Court merely that the properties, or one or more of them, were sold at an under value”.

**Duty imposed by s420A**

Justice Young considered what effect s420A had in the context of his analysis of the equitable duty. His Honour considered two previous cases which had considered s420A and drew exception with comments of Campbell J in *Artistic Builders* in which Campbell J said:

> In deciding whether there has been a breach of s420A, a Court looks at the process that a controller of property of a Corporation has gone through in selling that property. The inquiry is whether, in the course of that process, the controller has taken all reasonable care to sell the property for not less than its market value. It is not necessary to prove that the property was in fact sold for less than its market value – a controller could breach s420A, but, through luck, still manage to sell the property for its market value or more. Further, it is not necessary for me to find what actually was the market value of the property, to be able to find that s420A(1)(a) was breached – all that I need find is that the process gone through was not one where all reasonable care was taken to sell the property for its market value, whatever that market value might be.

Justice Young’s criticism of the pronouncement by Campbell J appears to be on the basis that if there was no damage occasioned by the breach then there would be no case in equity. That analysis appears to ignore the penalty provisions associated with s420A and does not, in any event, appear to be necessarily inconsistent with the Campbell J decision.

In *GE Capital*, Bryson J held that there are no rights conferred on mortgagors or guarantors by s420A but that they are able to take a benefit from the accounting in one of two ways. Either:

(a) in claiming an equitable set-off against the mortgagee; or

(b) invoking a line of authorities which recognise the rights of guarantors in circumstances where the principal creditor has acted to diminish the value of the security.

Justice Young said that in Australia, it is clear that if the mortgagee sues the guarantor, then the guarantor is able to say that the amount of the claim must be reduced by the amount at which the creditor sold the security at an under value as the guarantor was entitled to have the security sold for its proper value.
In the *GE Capital* case the effect of s420A was said to be that it resulted in some equitable rights flowing through to the mortgagor and guarantor.

Noting what appears to be a deliberate omission from s420A of a right of action, Young CJ said it would, however, be a complete nonsense to say that s420A was inserted into the Corporations Act with no consequences at all. His honour states that:

The Corporations Act is odd in that it provides various remedies in various parts of the statute but contains no overall provision for the enforcement of duties. The closest provision (putting aside s243 [which permits the Court to inquire into a receiver’s actions]) that might be applicable to the instant case is s598 [which enables a court to make orders as it thinks fit where satisfied that a person is guilty of fraud, negligence, default etc], the problem being however that the present plaintiffs are not eligible applicants.

Eligible applicants for that section are limited to ASIC, external controllers and persons authorised in writing by ASIC. The case makes no mention however of the Court’s powers under s1321. This section enables a person aggrieved by any act, omission or decision of a receiver or other external controller to appeal to the Court and gives the court power to make such orders as it thinks fit. This would appear to be the broad remedial power Young CJ was looking for. His Honour found that the purpose of the section, viewed in light of its drafting history, was to give some protection to borrowers. Justice Young concluded that the section gave rise to equitable damages. His Honour said:

In my view the breach of s420A gives rise to an action for equitable damages against the controller in the same way as there would have been an action to recover surplus proceeds of sale in equity where a mortgagee had wrongly sold the property contrary to the *Pendlebury Rule*. This is much the same conclusion that Bryson J reached in the *GE Capital* case.

Justice Young found that the plaintiffs’ claim must fail on the basis that neither a general equitable duty nor the duty under s420A operate to give a wronged party damages or compensation. The only effect is to adjust the accounting between a mortgagee and mortgagor or guarantor.

6. *Florgale Uniforms Pty Ltd (ACN 004 233 167) (rec and mgr apptd) (in liq) and Others v Orders and Another* [2004] VSC 65

**Background**

Florgale Uniforms Pty Ltd (*Florgale*) conducted a business manufacturing:

- industry uniforms;
- business wear;
- sporting apparel;
- health care apparel; and
- hospital linen.

Due to ongoing liquidity difficulties, the directors of Florgale were concerned about their respective liability for insolvent trading. The directors therefore resolved to appoint a voluntary administrator. The voluntary administrator:
• reduced staff from approximately 34 employees to 17 employees; and
• attempted to sell the Florgale business, but no sale eventuated.

As Florgale had executed a deed of charge in favour of NAB of approximately $1 million, the appointment of a voluntary administrator triggered an "event of default" pursuant to the deed of charge and the NAB appointed a receiver and manager effectively usurping the power of the voluntary administrator.

In addition to the deed of charge, certain directors of Florgale had executed guarantees in their personal capacities in NAB's favour.

The receiver, initially, did the following:
• had a meeting with the directors of Florgale and advised them that while he expected them to contact clients and deal with orders, that no sale was to be made without his consent; and
• continued to conclude sales, including sales at a discount, while attempting to sell the business as a going concern.

The receiver assessed, as indicated by his report given to NAB, that:

Given the size of the expected loss in the budget period a decision has to be made on whether to continue to trade. The advantages of continuing to trade are that a buyer may be found who will pay an amount for the goodwill for the group's various supply contracts. Further, there may be a saving as to termination payments. However, if I was to continue to operate the business, the losses have to be funded. Any losses incurred will erode the bank's security. Further, based on information contained in my investigating accountants report, the bank is likely to suffer a shortfall in relation to the properties owned by [Florgale].

Pursuant to this report, the receiver recommended that:
• the operations of Florgale should cease;
• the profitable work in progress be completed;
• stock on hand should be offered to customers at the best obtainable price provided this price is above the auction realisation price; and
• all unsold stock and plant equipment should be sold at auction.

After discussing the options with the directors of Florgale, balancing the advantages of disadvantages of continuing to trade, exhausting the prospective customer base and attempting to sell the business as a going concern, the receiver decided to auction the remaining stock.

The directors of Florgale disagreed with the receiver's chosen mode to sell the remaining stock, namely by auction. The directors contended that the best manner of sale for the clothing, being special purpose stock, was to approach the existing customer base and sell the clothing at a discount (the Suggestion). As suggested above by the quotation from the receiver's report to NAB, the Suggestion was not feasible to the receiver as it would require Florgale to continue trading for a longer period of time and incurring those associated costs.

The auction did not meet anticipated goals or raise sufficient funds to avoid the enforcement of personal guarantees of the directors of Florgale. The directors contended that the receiver had
breached his duty of care pursuant to s420A in selling the stock by auction and, due to this breach, the directors had suffered loss through the enforcement of their personal guarantees to NAB.

It was necessary for the Court to consider whether the actions of the receiver were a breach of the receiver’s duty of care and in so doing, considered:

(a) the ambit of s420A and specifically, whether a cause of action under s420A extends beyond the mortgagor to the guarantors and providers of collateral security; and

(b) the remedy conferred by s420A (for example, damages).

### Statutory provisions

Section 420A(1) of the Corporations Act 2001 (the Act) states:

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

(a) if, when it is sold, it has a market value—not less than that market value; or

(b) otherwise—the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.

A receiver and manager is a "controller" within the terms of s9 of the Act.

### The evidence

The receiver took detailed file notes which included the time and date of the respective meetings, the attendees, and included sufficient detail to indicate the substance of the meeting. In addition the receiver and the directors gave opposing evidence as to procedure and the valuation of the stock. There were massive differences in the opposing parties evidence, the most obvious difference being the different realisation values given to the stock. For example, one of the directors of Florgale, Mr Burnes’ testified that a six week closing down sale at a discount (as opposed to an auction) would have realised approximately $1.3 million, as opposed to the $100,000 received for the same stock by auction.

The Court consistently preferred the evidence of the receiver as opposed to the evidence of the directors. In this regard, the detailed file notes taken by the receiver assisted his defence greatly.

### Market value

Section 420A(1)(a) imposes a duty to take all reasonable care to obtain not less than market value for a property. Section 420A(1)(b) imposes a contrasting obligation to sell for the best price reasonably obtainable having regard to circumstances existing when the property is sold. It was therefore necessary for the Court to interpret these provisions to reconcile the seemingly contrasting obligations.

The Court considered earlier decisions on this issues, including the decision of Spigelman CJ in *Skinner v Jeogla Pty Ltd* (2001) 37 ACSR and of Bryson J in *GE Capital*. Justice Bryson amplified on Spigelman CJ’s earlier decision and stated:

In my opinion which of paras (a) and (b) is applicable depends on the degree of certainty with which value is ascertainable by reference to events in a market. Ascertaining value can have various degrees of certainty by reference to events in a market, including the definite value referred to by Spigelman.
CJ, declining to the determinable value to which his Honour refers, and declining further by degrees, and the language of s 420A(1) requires it to be understood that a degree of uncertainty can be reached at which there is not a market value and value is to be ascertained otherwise. In the meaning of the words in the subsection, a point is reached where market experience does not yield a market value with sufficient certainty to be used as an integer.

GE Capital concluded that s420A(b) only applies where it is not possible to determine the market value. The certainty with which market value can be determined is a continuum from considerable certainty (eg shares) through to very little certainty, and at some point there is so little certainty that for the purposes of the provision property can be said to have no market value and s420A(1)(b) therefore applies.

In Florgale, the Court stated that the case before it exposed a related uncertainty which arises from the terms of s420A, that is, the fact that the requirement in s420A(1)(a) to obtain not less than market value was not qualified by an express reference to the costs and risks involved in doing so. The Court held that the qualifying words "circumstances existing …" in s420A(1)(b) allows consideration of associated costs and risks; which consideration is not permitted by s420A(1)(a). The Court conceded that, on a literal reading, s420A(1)(a) could impose a duty to obtain market value irrespective of associated risks and costs, however, it decided that the obligation to sell for market value is prefaced by the general requirement to take all reasonable care, and permits matters such as associated costs and risks to be taken into account. In this way, the market value of Florgale’s clothing was not limited to the value of the clothing in isolation but, as part of this analysis, the Court may consider the associated costs of the different methods of sale in determining the market value.

On the facts of this case, while a private sale of the clothing may have produced a better sale, the associated costs of this method were far greater thereby making any gain from the sale redundant. Therefore a breach of s420A is not established merely because market value or the best price reasonably obtainable is not achieved, but rather requires proof of a failure by the receiver to take all reasonable care to sell the property for not less than market value or the best price that is reasonably obtainable having regard to the circumstances existing when the property is sold.

In addition to these considerations, the Court noted that the Florgale clothing was very specialised, and had a narrow or niche market. Due to this, there was no evidence of comparable sales which would permit market value to be readily determined for the clothing. Therefore, the plaintiffs failed to establish that the receiver failed to use all reasonable care to obtain market value or the best price reasonably obtainable in the circumstances.

The duties of a receiver

In considering the ambit of a receiver’s duty in exercising his/her power of sale, the Court noted that as s420A introduced a statutory duty which echoed the test deriving from Cuckmere Brick Co Ltd v Mutual Finance Ltd [1971] Ch 949 (the Cuckmere Test), the practical consequences of the differences between the test of good faith and the Cuckmere Test are, to a large extent, diminished, however, the Court did discuss the differences in the application of the duty of good faith, its connection to the general law duty and the statutory duty of a receiver, when exercising a power of sale. The Court held:

1. **good faith**: to ascertain whether a breach of the general law duty of a receiver has been breached, one must determine whether there has been a breach of good faith, that is,
whether the receiver was wilful and reckless in dealing with the property in such a way as to sacrifice the interests of the mortgagor;

2. **general law duty**: the general law duties of a receiver in exercising a power of sale are analogous to those of a mortgagee, that is, a mortgagee, exercising a power of sale, is liable for the defaults of its agents and for the negligent performance of bona fide acts;

3. **statutory duty**: a breach of s420A is not established merely because market value or the best price reasonably obtainable is not achieved, but requires proof of a failure to take all reasonable care to sell the property for not less than market value or the best price that is reasonably obtainable having regard to the circumstances of the case. These considerations permit matters such as associated costs and risks to be taken into account.

**The applicable remedy and its ambit**

It was also necessary for the Court to consider what remedy was applicable in such an application. The Court decided that, while s420A does not expressly confer a right to damages or any other remedy, there is a legislative intention that the mortgagor is to retain its existing available remedies by reference to the duty in s420A(1). In addition, s423 allows the Court to impose a remedy, including an order for damages occasioned by a breach of duty under s420A.

The Court also held that the guarantor is entitled to rely on the availability to the mortgagor of a remedy whether under the general law or from statute. The decision of the Court reads:

[Section 420A] does not vest an independent cause of action, but extends the duty owed by a controller, with the effect that all existing entitlements (including those of guarantors and collateral mortgagors) to equitable remedies in respect of a faulty or deficient exercise of the power of sale are enhanced and strengthened, by reference to the higher duty established by s420A.

**Conclusion**

The Court ultimately decided that the receiver had not breached his duty in exercising his power of sale. This was mainly due to the fact that Florgale could not afford to sell the clothing otherwise. In short, Florgale failed to establish that the receiver had failed to use all reasonable care to obtain market value or the best price reasonably obtainable in the circumstances then existing.

Justice Dodds-Streeton in *Florgale* compared Byron J's analysis in *GE Capital* with Young CJ's analysis in *Ultimate Property*. His Honour noted that Young CJ appeared to accept that s420A operated to vest a cause of action, whereas Bryson J considered that s420A only contributed to pre-existing rights of action, rather than creating independent new causes of action. The Court in *Florgale* preferred the approach of Bryson J in *GE Capital* on this issue.

The reasoning in *Florgale* is also at odds with the reasoning of Young CJ in *Ultimate Property* in that Young CJ found that there is no common law duty of negligence on a mortgagee in New South Wales which makes a mortgagee liable in common law damages if he or she fails to get a good price for the mortgaged property. The reasoning in *Florgale* in relation to the nature of the duty also seems more analogous to the reasoning employed by Campbell J in *Artistic Builders*.

The end result is that the precise nature of the obligation of corporate receivers when exercising a power of sale remains somewhat unclear as does the precise nature of the cause of action which may be available (and to whom) which accrues as a result of a breach of the duty.
7. **Some other difficulties which may be faced by receivers in realising assets**

The ordinary effect of appointing a receiver is that the floating charge will be crystallised and become fixed over the assets. Once the charge becomes fixed, the secured creditor obtains an equitable interest in the assets over which the security relates. That equitable interest revokes the company's power to deal with such assets in the ordinary course of business.

The appointment of a receiver does not, however, disturb the legal ownership of the company property. The receiver merely acts in the capacity as an agent of the company and is entitled to possession of the assets only in that capacity.

It is worthwhile bearing in mind that, ordinarily, receivers will not have access to:

(a) property which is the subject of a reservation of title clause;
(b) any recoveries made by a liquidator in respect of claims for unfair preferences;
(c) any property which the company holds in trust for some other party.

Another less common restriction which receivers may encounter when attempting to realise charged property is a restriction which may apply in relation to the receiver's right to repudiate pre-receivership contracts.

### 7.1 A receiver's right to repudiate pre-receivership contracts

On the appointment of a receiver a floating charge over assets of the company crystallises and permits a receiver to realise the assets which are the subject of the Charge as the agent of the company.

A receiver generally has all the powers that the company would have to realise those assets including the power to repudiate (or terminate) a contract.

The fact that a receiver has repudiated or terminated a contract does not affect the other party to the contract's rights to sue for damages which are occasioned by the termination of the contract. However, that right of action remains a right of action against the company alone and in many cases will amount to little more than an ability to prove for the alleged damages in a winding up of the company.

The general principle has been expressed to be that a receiver can repudiate a pre-receivership contract if the repudiation "will not adversely effect the realisation of assets or seriously affect the trading prospects of the company".

In the majority of cases where a receiver has been appointed, the future trading prospects of the company are so poor that the receiver need not have regard to whether or not the repudiation of a pre-receivership contract will adversely affect the realisation of the asset or trading prospects of the company. Thus, ordinarily, receivers can ignore those contracts which are a burden to the company or no longer of value and move on. Where the rights

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4 Watson v Duff, Morgan and Vermont (Holdings) Ltd (1974) 1 WLR 450, per Templeman J at p456
5 George Barker (Transport) Ltd v Eynon [1974] All ER 900
6 Airlines Airspares Ltd v Handley Page Ltd (1970) CH 193
under the contract have some value, receivers may also be able to repudiate the contract and sell those rights again. That is to say that, subject to certain limits, a receiver may strip the assets of the company and leave only the liabilities (or squeeze the lemon dry).

However, that general proposition may not be the case in circumstances where the contract contains what is referred to as a negative stipulation.

A negative stipulation is a clause which expressly prevents the company from taking some step. A common example of a "negative stipulation" are exclusive distribution agreements where a company has agreed not to sell its product other than to the specific distributor named in the contract.

In cases where there is such a negative covenant, the other party to the contract may have a "prior equity" which a court may intervene to protect – most commonly by granting an injunction restraining the company from taking the action which would contravene the negative covenant.

In *Re Diesels and Components Pty Ltd (Receivers & Managers Appointed)* (1985) 3 ACLC 555, it was held that a customs agent's contractual lien over a company's goods had the effect that the receiver could not get possession of the goods without first discharging the company's debt to the customs agent.

The Debenture Agreement in *Re Diesels* expressly permitted the receiver to disclaim contracts. However, those provisions were said to only govern the relationship between the Company and the secured creditor but did not affect or diminish the rights of third parties, such as the customs agent, who were not a party to the Debenture Agreement.

Justice McPherson in *Re Diesels* said:

> Those provisions of the debenture charge govern only the relations between the Company and the Bank. They cannot, and therefore do not, govern relations between the Company, the Bank, or the receiver on the one hand, and the respondent on the other, except to the limited extent that they may confer authority on the receiver to do acts on behalf of the Company or the Bank that he might otherwise not possess the power on their behalf to do. The rights of the respondent, which is not a party to that debenture charge, can not be diminished or affected by the terms of an instrument to which it is not a party. What is meant by saying that a receiver has power to "adopt" a pre-receivership contract is that he may refrain from repudiating it. If he repudiates the contract he renders the Company liable in damages for the breach of contract involved in that repudiation. Because the chargee who appoints him has the benefit of a security over the assets of the Company, the consequences of rendering the Company liable in damages are in practice felt only by the Company and through its unsecured creditors, and not by the holder of the charge. The Company's indebtedness to the chargee will be met out of the assets in priority to the claims of unsecured creditors including the claim for damages of the other party to the broken contract. The receiver therefore can, with virtual impunity, repudiate pre-receivership contracts.

However, McPherson J went on to note that there are exceptions to the rule. His Honour said:

> … There are cases in which damages may be an inadequate remedy for breach of contract, and where the other party may therefore be entitled to either specific performance or an
injunction that has the effect of obliging the Company, and through it the receivers and the chargee, to adhere to and perform the pre-receivership contract.

_Schering Pty Ltd v Forrest Pharmaceutical Co Pty Ltd & Ors_ [1982] 1 NSWLR 286 was a case in which a receiver was found to be bound by an express negative stipulation contained in a contract which prohibited the company (which was a supplier) from using any other distributor. The negative stipulation in that case was a clause which provided that the company would not market its goods except as provided for in the agreement. The agreement provided that the goods would be marketed through a nominated distributor.

The then Chief Judge in Equity in New South Wales, Helsham CJ, found that damages in that situation would not be an adequate remedy because, unless restrained, the receiver would continue to breach the contract and that damages would sound only against the company which did not have any capacity to pay. The right to seek injunctive relief to restrain a breach of that contract constituted a "prior equity".

In _Cater – King Pty Ltd v Westpac Banking Corporation & Ors_ (1989) 7 ACLC 993 the point was made that a receiver was not "entitled" to repudiate any contract but that if some contracts were breached the result is merely a liability to pay damages, however, other contracts, if breached, give rise to a claim for equitable relief which prevent the Company (and the receiver) from repudiating the contract.

Professor O'Donovan is quoted as saying:

> A receiver and manager appointed pursuant to a mortgage debenture creating a floating charge takes possession of the assets charged subject to all prior equities. It is this fundamental principle...which determines what unprofitable or onerous pre-receivership contracts he can repudiate. The prior equity which prevailed over the debenture holder's equitable assignment in _Schering Pty. Ltd v Forrest Pharmaceutical_ was the right to an injunction to restrain a breach of negative stipulation in a Franchise Agreement; in _Re Diesel and Components Pty Ltd_ it was a contractual lien.

It is worth noting, however, that Professor O'Donovan compared the equities not from the date the charge was granted, but rather from the time of the appointment of the receiver such that a contract entered into prior to the appointment of a receiver would take precedence over a floating charge which pre-dated it. However, what is not mentioned by Professor O'Donovan and does not appear to be considered by the authorities, is the situation in which the secured creditor has a fixed charge over proprietary rights which predate contractual arrangements which were later entered into. In those cases, there must be an argument that the fixed charge represents an equitable interest which pre-dates the contractual arrangement containing the negative stipulation.

_Schering v Forrest_ appears to be uncontradicted authority for the proposition that the receiver can be restrained from breaching pre-receivership contracts where those contracts contain an "exclusive dealing" covenant. It does so on the basis that exclusive dealing terms in contracts are characterisable as negative stipulations, breaches of which can be restrained in equity by an injunction.

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7 [Insolvency Law and Practice Seminar, Brisbane, 21 September 1990]
Having said that, the case law and commentary do not seem to take into account the equitable interest created in the secured creditor's favour by the debenture document itself meaning that the third parties' right to an injunction may well post-date the mortgagor's equitable interests in the assets under the charge. The cases also do not appear to have dealt with what the position would be in situations where the secured creditor had a fixed charge over contracts of the Company which a receiver later elected to repudiate.

Another difficulty with the decision in Schering is that MacPherson J granted an injunction on the basis that damages would not be an adequate remedy because the company would be insolvent. There may be an argument, which does not appear to have been raised in the Schering decision that there are circumstances in which damages would be an appropriate remedy and the fact that the company may not necessarily have the capacity to meet those damages is beside the point.

7.2 Intentional interference with contractual relations

Another potential difficulty which could be faced by receivers when repudiating pre-receivership contracts is the tort of intentional interference with contract.

The tort of intentional interference with contract can either be direct or indirect. Direct interference occurs where a person, with knowledge of the contract and intent to prevent or hinder its performance, persuades, induces or procures one of the contracting parties not to perform its obligations.

Indirect interference occurs where a person, with knowledge of the contract and intent to prevent or hinder its performance, commits some act, wrongful in itself, to prevent such performance.

Commonly, the security holder will be acutely aware of the assets of the subject company and the fact that the company is in financial difficulty. Prior to appointing a receiver it will have considered the likelihood taking such a step would have on the outcome.

A situation that can often arise after the appointment of a receiver is that significant assets of the company are in the form of exclusive contractual arrangements such as management or distribution rights. The secured creditor or a third party who is aware that the Company is in trouble and would like to purchase the company's assets free from any contractual relationship which the company may be bound by, may enter into arrangements with the secured creditor or receiver to the effect that, in the event a receiver is appointed, the third party will purchase the subject assets free from any encumbrances such as contracts. Both the secured creditor and the third party seeking to purchase the business must be very careful not to commit the tort of intentional interference with contractual relations.

The tort of procuring a breach of contract requires something more than simply accepting a benefit offered in breach of contract in circumstances where the person has already decided to commit the breach.

Security holders and receivers must be careful to ensure that any deals between the security holder and third party purchasers do not involve some form of inducement or persuasion on the Receiver to not perform the contract.
Having said that, the tort would not be committed if the receiver had already determined to repudiate the contract or if the contracts were to be terminated in accordance with their terms.

It may also be a defence to an action for direct interference with contract where the interference is justified. Whether or not an interference is justified would depend on the facts, however, there are cases in which if the ultimate purpose of the interferer is meritorious, the interference will be permitted.

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