Supreme Court of South Australia Decisions

FORTSON PTY LTD v COMMONWEALTH BANK OF AUSTRALIA & ANOR [2008] SASC 49 (4 March 2008)

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SUPREME COURT OF SOUTH AUSTRALIA
(Full Court)

FORTSON PTY LTD v COMMONWEALTH BANK OF AUSTRALIA & ANOR

[2008] SASC 49

Judgment of The Full Court
(The Honourable Chief Justice Doyle, The Honourable Justice Debelle and The Honourable Justice Bleby)

4 March 2008

MORTGAGES - MORTGAGES AND CHARGES GENERALLY - REMEDIES OF THE MORTGAGEE - SALE UNDER POWER - MODE OF EXERCISE OF POWER

Mortgage – mortgagee bank – default – bank exercised its powers as mortgagee and sold mortgaged hotel – bank had acted in breach of s 420A of Corporations Law – content of duty in s 420A(1)(a) to take all reasonable care to sell property for not less than market value – whether the judge had erred in assessing market value of hotel – whether Full Court able to determine market value – market value determined – appeal dismissed and cross-appeal allowed.

EVIDENCE - ADMISSIBILITY AND RELEVANCY - OPINION EVIDENCE - EXPERT OPINION

Valuer retained by bank to value hotel premises – valuer not employee of bank – valuer gives evidence – valuer later gives evidence on same valuation at re-hearing – valuer employed by bank at time of re-hearing – failure to make disclosure of valuer's employment – effect of failure to make disclosure.

Corporations Law s 420A, referred to.

Commercial and General Acceptance Ltd v Nixon [1981] HCA 70; (1983) 152 CLR 491; *Commonwealth v Arklay [1951] HCA 69;* (1952) 87 CLR 159; *FGT Custodians Pty Ltd v Fagenblat* [2003] VSCA 33; *Florgale Uniforms Pty Ltd v Orders [2004] VSC 65;* (2004) 11 VR 54; *Kyuss Express Pty Ltd v Sellers* (2001) 37 ACSR 62; *Spencer v The Commonwealth [1907] HCA 70;* (1907) 5 CLR 418; *Ultimate Property Group Pty Ltd v Lord [2004] NSWSC 114;* (2004) 60 NSWLR 646; *Whitehouse v Jordan [1980] UKHL 12;* [1981] 1 WLR 246, applied.

Liverpool Roman Catholic Archdiocesan Trustees Inc v Goldberg (No 3) [2001] 1 WLR 2337, not followed.

Jovanovic v Commonwealth Bank of Australia (2004) 87 SASR 570, discussed.

Anderson Stuart v Treleaven [2000] NSWSC 283; (2000) 49 NSWLR 88; *Brewarrana Pty Ltd v Commissioner of Highways (No 2)* (1973) 6 SASR 541; *Commonwealth v Milledge [1953] HCA 6;* (1953) 90 CLR 157; *Emerson v Custom Credit Corporation Ltd* [1994] 1 Qd R 516; *Festa v The Queen [2001] HCA 72;* (2001) 208 CLR 593; *Flavel v South Australia* (2007) 96 SASR 505; *GE Capital Australia v Davis [2002] NSWSC 1146;* (2002) 180 FLR 250; *Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd* [1976] VR 309; *R (Factortame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)* [2003] QB 381; *Skinner v Jeogla Pty Ltd* (2001) 37

ACSR 106; *Stead v State Government Insurance Commission [1986] HCA 54;* (1986) 161 CLR 141, considered.

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Full Court: Doyle CJ, Debelle and Bleby JJ

1. **DOYLE CJ**: I agree with the orders proposed by Debelle J. I agree with his reasons. There is nothing that I wish to add.
2. **DEBELLE J:** The events giving rise to this appeal have been protracted. There has already been a hearing in the District Court, an appeal to the Full Court, and a re-hearing in the District Court. This appeal and cross-appeal are from the orders made on the re-hearing in the District Court.
3. It is not necessary to recite all of the facts leading to this appeal and cross-appeal. It will suffice to note only the facts relevant to the issues in each.
4. In 1995 the appellant Fortson Pty Ltd ("Fortson") purchased a hotel property called the Plaza Hotel. The only directors and the controlling shareholders of Fortson are Mr and Mrs Jovanovic. The hotel is situated at 83-89 Hindley Street, Adelaide. It is about 250 metres west of the intersection of Hindley Street and King William Street. It is an unlicensed hotel providing accommodation at budget prices. The property included three shops at ground level. Fortson had purchased the hotel from a company called Roclin Developments Pty Ltd ("Roclin"). Roclin was controlled by two men called Mr Slavko Govedarica and Mr Milond Govedarica.
5. Fortson borrowed $750,000 from the Commonwealth Bank of Australia ("the Bank") to assist it with the purchase. The loan was secured by a mortgage over the hotel property, a charge over the business and a guarantee by Mr and Mrs Jovanovic.
6. By early 1997 Fortson had defaulted in repayments of the loan to the Bank. It was then in a desperate financial position. In February 1997 the Bank decided to exercise its powers as mortgagee and sell the hotel property by a private tender process. It did not advertise the sale of the hotel property in any public manner or place it on the open market.
7. On 22 May 1997, on instructions from the Bank, Mr Burton, a valuer employed by Knight Frank (SA) Pty Ltd, inspected the hotel property and assessed its market value at $660,000. On 14 July 1997 the Bank sold the hotel property to Roclin for the sum of $800,000. The Bank made a loan to Roclin of $620,000 to assist it in the purchase of the business. The Govedaricas guaranteed repayment of the loan. The contract for sale excluded from the sale "all goods,

chattels, plant, equipment and machinery and movable items not in the nature of permanent improvements in or about the land".

8. On 11 February 1998 the Bank commenced an action in the District Court of South Australia to recover the sum of $39,615.90 from Mr and Mrs Jovanovic, being the amount due under the guarantee they had executed. Mr and Mrs Jovanovic defended the action. In addition, Fortson and the Jovanovics made a counterclaim alleging, among other things, that the Bank had acted in breach of s 420A of the *Corporations Law* in that it had failed to take reasonable care to sell the hotel property for the best price that was reasonably obtainable having regard to the circumstances existing when the hotel property was sold. After a long hearing, Judge Lowrie gave judgment for the Bank in the sum of $77,643.93 and dismissed the counterclaim. Judge Lowrie held that, while the Bank owed a duty of care under s 420A of the *Corporations Law* to Fortson and to the Jovanovics, it had not acted in breach of that duty.

9. Fortson and Mr and Mrs Jovanovic appealed to the Full Court. On 3 March 2004 the Full Court (Mullighan, Gray and Besanko JJ) delivered judgment allowing the appeal and setting aside the orders made by Judge Lowrie: *Jovanovic v Commonwealth Bank of Australia* (2004) 87 SASR 570. The Full Court agreed with Judge Lowrie that the Bank did not owe a common law duty of care to either Fortson or to Mr and Mrs Jovanovic. It agreed with the judge that the Bank owed Fortson the duty prescribed by s 420A of the *Corporations Law* but held that the Bank had failed in that duty because it had sold the hotel property by private tender to one party with no advertisement or attempt to sell the property in a public manner.

10. The reasons of Besanko J, with whom Mullighan J agreed, differ in some respects from those of Gray J. For present purposes, the differences are immaterial. I refer only to those aspects of the decision relevant to the issues on this appeal and cross-appeal. None of the judges expressly specified whether the Bank had acted in breach of paragraph (a) or paragraph (b) of s 420A(1). However, it is implicit in the reasons for judgment that the hotel property had a market value and that the Bank had failed to take all reasonable care to sell the property for not less than market value in breach of s 420A(1)(a). All members of the court held that the Bank had failed in its duty because it did not appoint an agent nor put the property on the open market nor conduct a proper marketing campaign.

11. The majority of the court (Besanko and Mullighan JJ) held that the duty imposed by s 420A did not sound in damages. They applied the reasoning of Bryson J in *GE Capital Australia v Davis [2002] NSWSC 1146;* (2002) 180 FLR 250 at [53], [54] and [56] and held that the remedy was in equity so that the mortgagor was to be credited with compensation when accounts are taken of the mortgage debt. The compensation would be the difference, if any, between the price obtained and market value. Similarly, the Jovanovics as guarantors were entitled to be credited with the difference between the price obtained and market value.

12. In his reasons Besanko J considered the question as to the price which would have been obtained if the Bank had performed its duty under s 420A. He said:

[117] The question remains as to the price which would have been obtained for the freehold title of the property had the bank taken all reasonable care in terms of the section. In the circumstances of this case that involved appointing an agent, conducting a proper marketing campaign and putting the freehold title of the property to the market. The difference between the price which would have been obtained had that been done and the price the bank in fact obtained, together with appropriate adjustments in relation to the expenses of the sale, is the measure of the loss for the breach of the duty in s 420A. Unfortunately, this Court is not in a position to determine that figure. It involves an assessment of the valuation evidence including an assessment of the extent to which that precise issue has been addressed by the valuers, and a determination as to the valuation evidence which should be preferred. It may be noted that the market value as defined by one or more of the valuers who gave evidence is not necessarily the same as the sale price that would have been achieved had the bank appointed an agent, conducted a proper marketing campaign and put the freehold title of the property to the market.

[118] The question which I have identified must be determined by the judge and it will be a matter for him whether, if the parties wish to call further evidence, he allows that to be done. If the conclusion is reached that there is a difference, then Fortson is entitled to have the difference brought to account in the taking of accounts between it and the bank. Depending on the figure, it may or may not have a counterclaim. The Jovanovics are entitled to bring to account by way of an equitable set off to the claim on the guarantee the difference, if there be a difference. As guarantors they are not entitled to bring a counterclaim, and although they were directors and shareholders of Fortson, they are not entitled to claim for loss sustained by the company: *Gould v Vaggelas [1985] HCA 75;* (1985) 157 CLR 215. For these reasons, I disagree with the conclusion of Gray J that the Jovanovics are entitled to pursue their counterclaim against the bank.

In the last sentence of paragraph [117] and in paragraph [118], Besanko J appears to draw a distinction between market value and the price which would have been achieved had the Bank appointed an agent and put the property on the open market with a proper marketing campaign. For the reasons to be given in a moment, that is not the relevant inquiry and I do not think that Besanko J intended to say that it was.

13. The action was remitted to Judge Lowrie for further hearing and determination of the issue identified in paragraphs [117] and [118]. The terms of those paragraphs were to cause difficulty on the re-hearing.

14. Judge Lowrie began the re-hearing in September 2004. After three days the judge disqualified himself on the ground of perceived bias. The action was assigned to Judge Lee for hearing and determination.

15. On 22 December 2005, after a long hearing of some seven days, Judge Lee gave directions as to the evidence to be led on the re-hearing. The judge published detailed reasons for judgment which dealt with the question he had to

consider and the directions as to the calling of further evidence. It is apparent from those reasons that the reasons of Besanko J had led to debate as to the question to be determined. It was common ground that the hotel property had a market value. Judge Lee expressed his understanding of the issues in these terms:

> 7. There is no suggestion that the property did not have a market value. So subsection (1)(a) applies. The duty is not to take reasonable care in a general sense. It is a duty to take all reasonable care to sell for not less than market value. It must follow that the duty is not discharged merely by the obtaining of market value. If there is an opportunity to sell for more, the mortgagee's failure to take that opportunity may amount to a breach of the section.
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> 8. When it comes to the measure of any loss, there is a difference between asking "What is the market value of the property?", and asking "What price would be achieved by taking all reasonable care to sell the property for not less than market value?". The second question, unlike the first, does not focus exclusively upon market value. Assets are often sold under or over their market value. Sometimes a buyer with a special interest in acquiring an asset will pay a premium on market value. So the second question would permit consideration of information that a buyer was prepared at the relevant time to pay more than market value.

After referring to paragraphs [117] and [118] of the reasons of Besanko J, Judge Lee said:

> 10. Two points emerge. The issue for determination is "the price which would have been obtained for the freehold title of the property had the Bank taken all reasonable care in terms of the section". In the particular circumstances of this case, the requirement to take "all reasonable care in terms of the section" would have been met by the Bank "appointing an agent, conducting a proper marketing campaign and putting the freehold title of the property to the market".
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> 11. It is apparent that the witnesses who gave oral evidence about the value of the property did not pose the correct question for themselves, that is, the question which arises from s 420A. Each purported to advise on market value.

Having identified the issue he had to determine in those terms, Judge Lee noted that the persons who had given evidence as to value before Judge Lowrie had not addressed that question but had given evidence as to market value. He ruled that the parties could not call any further evidence other than to recall three witnesses, Messrs Burton, Williamson and Taylor, who had given evidence as to value before Judge Lowrie.

> 16. Judge Lee directed at [26] that the ultimate question for those witnesses to consider was:

price would have been obtained for the freehold title of the property in July 1997 had the Bank appointed an agent, conducted a proper marketing campaign and put the freehold title of the property to the market?

The judge then added at [27]:

I have already said, this question would permit consideration of information that a buyer was prepared at the relevant time to pay more than market value. It would be necessary, however, that there be reliable information upon which a positive finding could be based. Mere conjecture would not be enough. Moreover, any such buyer would had to have been genuine and at arms length. I would not attach any weight to any offers said to have passed between the Govedaricas and the Jovanovics.

These passages from the judge's reasons of 22 December 2005 disclose an error as to the question he had to determine. I will deal with that issue in a moment.

> 17. After a hearing over four days, the judge published reasons for judgment on 30 November 2006. He held that the best price reasonably obtainable for the hotel property was $870,000. On 16 May 2007, he made orders to give effect to his reasons. He dismissed the Bank's claim against Mr and Mrs Jovanovic. On the counterclaim he ordered that the Bank pay Fortson the sum of $10,323.64, together with interest in the sum of $7,000. He ordered the Bank to pay Mr and Mrs Jovanovic 90 per cent of the costs of defending the action and to pay Fortson 90 per cent of the costs of the counterclaim.
> 18. Fortson has appealed against that part of the orders of Judge Lee made on 16 May 2007, by which he ordered that the Bank pay the sum of $10,323.64 to Fortson, together with interest in the sum of $7,000. There are many grounds of appeal. Essentially, the appeal is on the ground that Judge Lee erred in his treatment of the evidence of value and that the value of the hotel property is more than $870,000. Fortson contends that the hotel property would have sold for a price not less than $1.5 million.
> 19. The Bank has cross-appealed against the orders made by Judge Lee on 30 November 2006 and 16 May 2007. It contends that the judge erred in finding that the price at which the hotel property would have sold was $870,000. It says that the price would have been less than that sum. It also appeals against all of the orders made on 16 May 2007. Essentially, the Bank's case on appeal is that Judge Lee erred in his approach to the question of market value. The Bank relies on three main grounds. Shortly stated, they are:
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> 1. That the task for the judge was to determine the market value of the hotel and he should have found that the market value was not more than $800,000;
> 2. That, even if Judge Lee had correctly found that the sale price was $870,000, he had erred in finding the amount payable to the Bank which, if corrected, resulted in judgment for the Bank;
> 3. That the Judge had erred in making the order as to costs.

The Bank seeks orders setting aside the orders of Judge Lee and, in their place, orders giving judgment for the Bank and dismissing the counter-claim with orders as to costs in favour of the Bank.

> 20. Before the hearing of the appeal began, Mr Sallis, who appeared for Fortson, applied to this Court to tender two affidavits of Mr Jovanovic, sworn on

22 and 27 August 2007, and an affidavit of Mr Cole, sworn on 29 August 2007. Mr Sallis also applied on behalf of Fortson for leave to file a supplementary notice of appeal. The main issue addressed by the supplementary notice of appeal and affidavits was the non-disclosure by the Bank of the fact that Mr Burton, the valuer called by the Bank, had been employed by the Bank at the time of the re-hearing before Judge Lee. Mr Forster SC, who appeared for the Bank, applied to tender an affidavit of Mr Leydon, sworn on 29 August 2007, on the same issue. The Court admitted

- the affidavit of Mr Jovanovic, sworn on 22 August 2007, with the exception of paras 13-23 thereof;
- the affidavit of Mr Cole, sworn on 29 August 2007; and
- the affidavit of Mr Leydon, sworn on 29 August 2007.

Leave was granted to Fortson to file the supplementary notice of appeal.

21. Both the notice of appeal and supplementary notice of appeal filed by Fortson are inordinately lengthy. Much of what purports to be grounds of appeal is, in fact, argument. The grounds of appeal can be distilled to one main ground, namely, that Judge Lee had erred in finding that the price which should have been obtained for the hotel property was $870,000. Fortson contends that its value was at least $1.5 million. The rest of the notice of appeal sets out asserted errors on the part of the judge in reaching his conclusion and in weighing the evidence of the witnesses, Mr Burton and Mr Williamson, and an asserted failure of the judge to apply correctly the evidence of Mr Stefanovic, an employee at the Plaza Hotel. Fortson seeks an order from the Full Court that the sale price be fixed at $1.5 million or, in the alternative, that the question of the sale price be remitted to a different judge of the District Court for yet another hearing.

22. Fortson's supplementary notice of appeal essentially complains of the non-disclosure that Mr Burton was an employee of the Bank when he gave his evidence. It is not entirely clear what relief Fortson seeks on that ground.

23. In the result, four broad questions fall for consideration on this appeal. They are:

1. Did the judge err in determining the question he had to consider?
2. Did the judge err in assessing the market value of the hotel?
3. What are the consequences of the failure to disclose that Mr Burton was an employee of the Bank when he gave his evidence before Judge Lee?
4. What orders should be made as to the costs of the actions?

Market Value

24. Judge Lee found that the hotel property had market value. There is no appeal from that decision nor indeed could there be. There can be no doubt that the hotel property had market value. Indeed, the parties have proceeded on the footing that the hotel property had market value. However, for the reasons which follow, the judge erred in his approach to the question he had to decide.

25. As the hotel property had market value, the provisions of 420A(1)(a) of the *Corporations Law* applied and the issue for determination was what was the market value of the hotel property. Although the use of market value in s 420A has been the subject of comment in decisions such as *Skinner v Jeogla Pty Ltd* (2001) 37 ACSR 106; *GE Capital Australia v Davis*; and *Florgale Uniforms Pty Ltd v Orders [2004] VSC 65;* (2004) 11 VR 54, none of the issues discussed therein affect the issues for determination in this case. All that has to be determined in this case is the market value of the hotel property.

26. The classic definition of market value is that expressed by Griffiths CJ and Issacs J in *Spencer v The Commonwealth [1907] HCA 70;* (1907) 5 CLR 418. Griffiths CJ said at 432.

my judgment the test of value of land is to be determined, not by inquiring what price a man desiring to sell could actually have obtained for it on a given day, i.e, whether there was in fact on that day a willing buyer, but by inquiring "What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?" It is, no doubt, very difficult to answer such a question, and any answer must be to some extent conjectural. The necessary mental process is to put yourself as far as possible in the position of persons conversant with the subject at the relevant time, and from that point of view to ascertain what, according to the then current opinion of land values, a purchaser would have had to offer for the land to induce such a willing vendor to sell it, or, in other words, to inquire at what point a desirous purchaser and a not unwilling vendor would come together.

At 441 Issacs J said:

arrive at the value of the land...we have, as I conceive, to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser, willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land, and cognizant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood, as then appearing to persons best capable of forming an opinion, of a rise or fall for what reason soever in the amount which one would otherwise be willing to fix as the value of the property.

It is implicit in these remarks that the land has been advertised for sale on the open market. The remarks of Issacs J, in particular, denote a prudent vendor cognisant of all circumstances which might affect the value of its land. One means of ensuring that the highest price is obtained is to put the land for sale on the open market and to advertise it for sale. It is also implicit that the vendor and purchaser are dealing at arms length. Market value is, therefore, the price that a willing purchaser would have to pay a vendor willing but not anxious to sell in order to obtain the land: *Commonwealth v Arklay [1951] HCA 69;* (1952) 87 CLR 159 at 170.

27. The duty expressed in s 420A(1)(a) is a duty to take all reasonable care to sell the property for not less than market value. This duty is the same duty as the statutory duty imposed in some States upon mortgagees that requires them, when exercising the power of sale, to take reasonable care to ensure that the property is sold at market value. In *Commercial and General Acceptance Ltd v Nixon [1981] HCA 70;* (1983) 152 CLR 491 the content of that duty was considered. It requires the mortgagee to put the property on the open market and bring it to the attention of potential purchasers by advertising and responding to all enquiries and expressions of interest: *Commercial and General Acceptance Ltd v Nixon* at 495 per Gibbs CJ and at 505 per Mason J; see also *Emerson v Custom Credit Corporation Ltd* [1994] 1 Qd R 516. That same duty is imposed upon a controller by s 420A(1)(a): *Kyuss Express Pty Ltd v Sellers* (2001) 37 ACSR 62 at [93] to [95]. That duty also required the Bank to take reasonable steps to ascertain the value of the hotel property before selling it: *Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd* [1976] VR 309. The prudent vendor as described by Griffiths CJ and Issacs J is a person who is cognisant of current land values and all circumstances which affect that value, either advantageously or prejudicially, and of the then demand for land of that kind. By this means, an objective determination of market value may be made. It is what Spigelman CJ called "determinable value": *Skinner v Jeogla Pty Ltd* at [40]; *Kyuss Express Pty Ltd v Sellers* at [93].

28. It is against that background that the remarks of Besanko J in paragraphs [117] and [118] must be understood. In the first part of paragraph [117], Besanko J is drawing a contrast between what the Bank in fact did, namely, offer the hotel property privately to one person for sale and what it ought to have done, namely, put the hotel property on the open market and advertise it for sale. As His Honour noted, the measure of the compensation is the difference between the price which would have been obtained had that been done and the price in fact obtained, together with appropriate adjustments in relation to the expenses of sale. It is appropriate to add that, even if the controller did not exercise reasonable care but the property was in fact sold for its market value, the mortgagor will not have suffered loss and will not succeed. It will be a case of *injuria sine damnum*: *Ultimate Property Group Pty Ltd v Lord [2004] NSWSC 114;* (2004) 60 NSWLR 646 at [69]. *Kyuss Express Pty Ltd v Sellers* is an example of such a case.

29. It is apparent from the reasons of Judge Lee that he believed that in the balance of paragraph [117] and in paragraph [118] Besanko J was drawing a distinction between market value and the price that would have been achieved if the property had been sold on the open market with appropriate advertising. It is not clear why Besanko J added those comments. Two witnesses as to value were Mr Burton and Mr Williamson. Both had given evidence before Judge Lowrie. Both had adopted a similar definition of market value. Mr Williamson adopted the definition promulgated by the Australian Property Institute, namely:

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

That definition accords with the views expressed by Griffiths CJ and Issacs J in *Spencer v The Commonwealth*. Mr Burton adopted a definition in almost identical terms.

> 30. The last sentence in paragraph [117] is, with respect, expressed a little unfortunately and is capable of being misunderstood. It has the capacity to suggest that there is a difference between market value and the sale price achieved by a sale on the open market. That is not correct. In the ordinary course, the sale price achieved on the open market is market value. The price paid by the prudent purchaser will be the price negotiated by voluntary bargaining between the vendor and purchaser, both willing to trade, but neither so anxious that either will overlook any ordinary business consideration. Alternatively, it will be the price paid at auction by a prudent purchaser. There are, of course, exceptions to that general rule. The purchaser may not be prudent and so pay a price higher than market value or there may be circumstances which constrain the vendor to sell so that he has no alternative but to accept a price less than market value. In some instances at an auction, two or more bidders may be so anxious to purchase the land that the sale price is a price above market value. In the last case, the purchasers have put ordinary business considerations to one side because of the desire of each to purchase the land. The only purpose of the last sentence in paragraph [117] is to draw a distinction between the definition of market value adopted by one of the valuers and market value as it should ordinarily be understood. I do not understand the reasons of Besanko J to suggest that there is a distinction to be drawn between market value and the price secured on the open market. Furthermore, when the reasons of Besanko J are read as a whole, it is apparent that his intention was that there be a determination of market value in the conventional sense. In paragraphs [95] and [96] of his reasons he refers on several occasions to market value.
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> > 95. The judge discussed the scope of the section briefly. He noted correctly that the section does not stipulate a correct method of sale. He referred to the decision of Campbell J in *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd* [2002] NSWSC 16, and noted that in that case it was said that in deciding whether there has been a breach of the section the court will look at the process the holder of the power goes through in selling the property. That is no doubt correct. The market value may be a relevant item of evidence on the question of whether there has been a breach of duty, but it is by no means decisive. It may be possible, although I would have thought fairly rare, that a controller would take all reasonable care to sell the property for not less than market value, and yet, for some reason outside his or her control, not obtain not less than market value. It is certainly possible that a controller might not take all reasonable care to sell the property for not less than market value and yet be fortunate enough to obtain market value. In that situation, those to whom the duty is owed may establish a breach of duty but no entitlement to relief.
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> > 96. In the context of his discussion of s 420A of the *Corporations Law*, the judge referred to a passage in *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd* (supra) that suggested that the relevant

> question in determining breach of duty was whether "any departure from reasonable standards [was] so serious as to be properly characterised as unconscionable, in order to render the mortgagee accountable". However, that comment was made by Campbell J in the context of a discussion of the relevant equitable duty, not the duty in s 420A. The judge erred insofar as he said that it was the relevant question for the purposes of s 420A. The relevant question for the purposes of s 420A is whether the controller has taken all reasonable care to sell the property for not less than its market value and that in turn involves a consideration of whether the controller: failed to do what a reasonable and prudent person would do, or has done what a reasonable or prudent person would refrain from doing in the circumstances". *and General Acceptance v Nixon* (at 501) per Mason J (as he then was) at 501).

It is apparent from those passages that he is using the expression "market value" in the sense defined in *Spencer v The Commonwealth.*

> 31. The reasons of Judge Lee published on 22 December 2005 disclose that he misunderstood the effect of paragraphs [117] and [118] of the reasons of Besanko J. He drew a distinction between market value and the price which would have been obtained had the Bank sold the property on the open market with a proper marketing campaign. The passages already quoted from the reasons of the judge demonstrate his misunderstanding of the issues. It is appropriate to refer to other passages from his reasons of 22 December 2005 when ruling that the three witnesses who had given evidence as to the market value of the hotel property could be recalled. The judge said:
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> > 26. As for the conditions upon which further evidence is to be called, I rule that the parties should not call other than the witnesses who gave oral evidence before the primary judge, namely Messrs Burton, Williamson and Taylor. The ultimate question for the witnesses to consider is: "What price would have been obtained for the freehold title of the property in July 1997 had the Bank appointed an agent, conducted a proper marketing campaign and put the freehold title of the property to the market?"
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> > 27. As I have already said, this question would permit consideration of information that a buyer was prepared at the relevant time to pay more than market value. It would be necessary, however, that there be reliable information upon which a positive finding could be based. Mere conjecture would not be enough. Moreover, any such buyer would had to have been genuine and at arms length. I would not attach any weight to any offers said to have passed between the Govedaricas and the Jovanovics.

Nowhere in the judge's reasons published on 22 December 2005 nor in his later reasons for judgment did the judge consider the definition of market value in *Spencer v The Commonwealth.*

32. For these reasons, the judge fell into error in drawing the distinction between market value and the price obtained after appointing an agent, conducting a proper marketing campaign and putting the freehold title of the property to the market. Instead of determining market value, he has sought to determine the best price which might have been achieved. That is not what s 420A(1)(a) requires. See *Ultimate Property Group Pty Ltd v Lord* (supra); *Kyuss Express Pty Ltd v Sellers* (supra); *Florgale Uniforms Pty Ltd v* Orders (supra). There is no duty to sell for more than market value. That is an obligation not capable of objective determination. The task the judge should have undertaken was first to determine market value. Once that task was completed, the judge would be in a position to determine what, if any, remedy was available to the appellant.

33. The judge's error was to infect the conduct of the re-hearing and the judge's reasoning when determining market value. Although the judge erred in his approach on the question of market value, the evidence is sufficient to enable this court with the assistance of some aspects of the judge's reasons to determine market value. It is desirable that it should do so to avoid the parties having to incur the cost of yet another hearing. I will return later to that question after a review of the evidence.

The Valuers

34. Although Judge Lee had ruled that the three valuers called before Judge Lowrie could give further evidence on the re-hearing, only two were called. They were Mr Burton who was called by the Bank and Mr Williamson who was called by the appellant. The appellants did not recall Mr Taylor.

35. Mr Burton prepared his valuation in May 1997. He therefore had the advantage of making his valuation at or about the time when the hotel property was to be sold. At that time, Mr Burton was a valuer employed by Knight Frank (SA) Pty Ltd, licensed real estate agents and valuers. Mr Burton's valuation was in a conventional form. It described the subject property, it listed the factors affecting value, it described the valuation method, listed comparable sales and concluded with an assessment of value. In 1999, Mr Burton left Knight Frank and was employed by Deutsche Bank and later by ABN AMRO Morgans. In 2004 he became an employee of the Bank. I deal later with the question whether the failure to disclose his employment by the Bank has any consequences for the issues in this appeal.

36. Mr Williamson had trained as a valuer and for a time conducted a valuation practice. In more recent years he has acted as a sales consultant and agent for the sale of hotel properties. He is extensively involved in that business and in consequence has not in recent years undertaken valuation work. Mr Williamson conceded both before Judge Lowrie and before Judge Lee that his report was not a valuation. As he said, he had not prepared a valuation. Instead, he had been asked to examine and comment on Mr Burton's valuation. There can be little doubt that Mr Williamson has an extensive knowledge of hotel properties and of the means of selling them. Both his report and his initial evidence read like

a report of a salesman. As will appear, his approach was over-optimistic. The difference between his report and Burton's valuation was not as marked as it became at the re-hearing. That was the result of the fact that Williamson abandoned a number of the facts and propositions on which he relied in his initial report. He sought to justify his later approach on the basis of the evidence of a Mr Stefanovic to which the judge had referred in his reasons of 22 December 2005. That evidence did not justify discarding his initial approach. In my view, there was a degree of opportunism in his evidence. Another defect in Mr Williamson's report stems from the fact that he was not instructed to prepare it until May 2002, some five years after the sale. He did not, therefore, have the advantage available to Burton of making his report in light of a knowledge of current factors affecting value. I later make some other criticisms of Mr Williamson's evidence.

37. Judge Lee expressed some general remarks about the reliability of the evidence of Mr Burton and Mr Williamson. He acknowledged that Mr Burton was a licensed valuer who had practised in that field. He described Mr Williamson as a "sales consultant with considerable experience in the tourism and hospitality industry". He described him in his reasons as a valuer merely for convenience.

38. The judge considered that the weight of Mr Burton's evidence was diminished by his "professed inability to reconsider his earlier views". He gave some illustrations. However, it must be appreciated that Mr Burton was in an extremely difficult position. His original valuation report was written in May 1997 when he was in active practice as a valuer with Knight Frank (SA) Pty Ltd. After he had left Knight Frank in 1999 and moved to Sydney, he did not conduct a valuation practice. He had given evidence before Judge Lowrie in March 2003 and was required to give evidence before Judge Lee in May and June 2006. At that time he was no longer practising as a valuer.

39. It is apparent from his evidence before Judge Lee that Burton did not have access to his notes and working papers of nine years earlier. He believed that the matter had been resolved. He therefore had difficulty in recalling the detail of some of the enquiries he had made for the purpose of his valuation. He was not giving evidence of a current valuation. He was justifiably not prepared to adjust his valuation on facts of which he was not aware and which he had had no opportunity to verify. It was therefore not surprising that he was reluctant to depart from his opinions formed in 1997 after due enquiry. He cannot reasonably be criticised for that.

40. Judge Lee rejected Mr Williamson's evidence as to the likely average room rate for the Plaza Hotel, a rate which was in excess of that used by Mr Burton. The Judge in fact adopted a range less than that of Mr Burton.

41. The judge rejected Mr Williamson's evidence as to occupancy rates and, as will be seen, based his conclusion on inadmissible evidence. He also rejected Mr Williamson's evidence as to the rent to turnover rate and without justification adopted a rate not supported by either valuer.

42. The judge was unable to resolve the differences between the two witnesses as to capitalisation rate by accepting the view of one and rejecting the other. On that topic the Judge ultimately selected his own capitalisation rates for different categories of purchaser and conducted an averaging exercise.

43. As will later be seen, the process adopted by Judge Lee in arriving at the answer to what he perceived to be the question posed by the Full Court was flawed. At no relevant point did it involve acceptance of Mr Williamson's evidence. It did involve, to a significant extent, the acceptance of Mr Burton's figures or of figures which had the effect of lowering Mr Burton's final figure.

44. Given all the factors I have addressed, and for reasons that will become apparent, the evidence of Mr Burton is the more reliable notwithstanding that he made a few errors (mainly mathematical) to which I will later refer. To act on his evidence in the circumstances I have described is not to usurp the function of the trial Judge in assessing the credit or reliability of witnesses.

The Hotel Property

45. It was common ground that at the date of sale the hotel property was in a very poor state of repair. The retail shops which had a frontage to Hindley Street were of a basic standard and in some disrepair. The hotel itself was in a very poor state of repair. There was evidence of roof leaks in the ceilings of some rooms located on the top floor. Some of the rooms could not be used because of those leaks. Other rooms offered a very basic level of accommodation. In Burton's opinion, considerable money would have had to be spent in order to upgrade the retail shops and the hotel premises. That was not disputed by Williamson.

46. The hotel is located some 250 metres west of the intersection of Hindley Street and King William Street. It is, therefore, not far distant from Rundle Mall. The hotel was an unlicensed hotel providing accommodation at budget tariffs. Judge Lee described it as an "unlicensed budget style hotel". Mr Williamson described it as an hotel at the lower edge of the accommodation spectrum. It is within walking distance of the campus of the University of South Australia in Morphett Street. The development surrounding the hotel property comprises a variety of older style retail strip shopping and a variety of entertainment venues. The hotel itself comprises some 67 rooms at three levels. The building is an older style building constructed with a combination of clay brick and bluestone. The bedroom accommodation is on the upper two levels. Fourteen rooms have en-suite facilities. When inspected by Mr Burton, one of the three shops was vacant. The Jovanovics operated one shop as a newsagency and a tenant occupied the third shop.

47. Mr Burton expressed the view that in the years prior to 1997, Hindley Street had deteriorated in terms of its value and as a source of entertainment. While it had been a centre for night time entertainment in Adelaide, that function had shifted to premises in Rundle Street. In Mr Burton's view, Hindley Street was not an attractive area for investment. He said:

the opening of the University of South Australia campus further along Hindley Street, there appears to be little increase in activity in Hindley Street east of Morphett Street. The lack of activity is evident in the fact that the hotel located on the corner of Hindley and Morphett Streets is vacant. Furthermore, building owners along Hindley Street have not upgraded their premises and this creates a negative perception of the street as old and in disrepair.

of these factors lessen the chances of a purchaser being found for the Plaza Hotel. However a positive aspect is the fact that there are a number of investors who own properties along Hindley Street. They may seek to expand their holdings further and it is to these investors that the Plaza Hotel may appeal.

POTENTIAL

the state of disrepair of the premises, the lack of trading details available from the Plaza Hotel operation and the fact that there are vacancies on the ground floor, we consider that the subject property would have very limited appeal in the current market place. The lack of trading details for the Plaza Hotel raises questions concerning the profitability of the business, especially given the disrepair of the premises. At present an investor would be faced with a substantial cost to upgrade the premises, with only minimal rental income provided. The Game Quest tenancy, which is the only formally leased portion of the premises, is due to expire on the 4th September 1997. While we do not know whether the tenant will vacate, it does raise the question and therefore lower the marketability of the premises.

property investor would be very wary of the income producing potential of the hotel and the fact that Hindley Street as an entertainment venue has deteriorated in recent years. Consequently the purchaser would be faced with an initial capital expenditure with the prospect of vacancies in the short term and what may be an enviable (sic) hotel operation. We do not consider that this scenario would appeal to many investors in the market place and consequently an extended selling period of in excess of six months may well be required in order to dispose of the property.

I do not understand the evidence of Mr Williamson to call this assessment into question.

Valuers Confer Before Re-Hearing

48. Judge Lee had directed that the valuers should confer under the supervision of a Master of the District Court before the resumption of the re-hearing. The purpose of the conference was not to negotiate a compromise but, instead, to enable the witnesses to identify those matters on which they agreed and those matters on which they differed. The witnesses were to prepare a joint statement concerning those matters which was to be signed by each. The conference took place before Master Norman on 15 February. A statement was prepared and signed by both Burton and Williamson and delivered to the judge.

49. In his reasons published on 22 December 2005, Judge Lee had referred to evidence given before Judge Lowrie by Mr Stefanovic. Mr Stefanovic had been employed at the hotel as a night manager between March 1992 and June 1998. His duties included checking lodgers in and out of the hotel. Judge Lee summarised his evidence and expressed the view that the occupancy rate was 79 per cent. Later, when he made his final decision, the judge reduced that assessment.

50. At the conference before Master Norman, Mr Williamson noted the evidence of Mr Stefanovic and said that in his view the occupancy rate was 75 per cent. That caused him to adjust his estimated rental to $115,000 in lieu of his earlier assessment of $75,000. Mr Burton, however, maintained his estimate of

$70,000. In his view, the evidence of Mr Stefanovic could not be looked at in isolation. Other relevant issues discussed at the conference are noted later in these reasons.

51. When the valuers were called on the re-hearing, their evidence was not taken in the usual way. Instead, both were sworn and counsel were then given the opportunity to examine them in turn on a series of issues. While this procedure might in some circumstances be suitable, it proved to be entirely inappropriate on this occasion when the issues were at large. It would have been preferable if the two valuers had been examined, cross-examined and re-examined in the usual way.

The Method of Valuation

52. Judge Lee did not make any formal ruling as to the extent to which the evidence before Judge Lowrie should be evidence before him. It appears to be implicit in his preliminary reasons published on 22 December 2005 that the re-hearing should proceed on the evidence before Judge Lowrie supplemented by evidence from the three valuers. Indeed, the evidence of Mr Stefanovic on which Mr Williamson relied was only given before Judge Lowrie. However, as already mentioned, the appellant did not recall Mr Taylor. Judge Lee did not refer to Taylor's evidence. Neither the appellant nor the Bank have asked the court to refer to it. I have had regard only to the evidence of Burton and Williamson as they were the only valuers whose opinions were again tested in the course of the re-hearing.

53. Mr Sallis submitted on more than one occasion that Mr Burton had done a valuation on the basis of a forced sale, what Mr Sallis called "a valuation for mortgage purposes". The criticism is entirely unfounded. A glance at Mr Burton's valuation shows that he determined market value and added a note as to the value of the hotel property on a forced sale.

54. Both Burton and Williamson agreed that the market value should be assessed by capitalising the rental of the hotel, an approach frequently adopted in respect of premises which are rented or hired when there is little or no evidence of comparable sales of like property. As this hotel was not let to a person who operated the hotel business, it was necessary to estimate the rental. Both valuers based their calculation of the imputed rental upon their estimate of the revenue of the hotel (determined by applying an occupancy rate to an average rate per room) to which they added the rent for the three shops. They then used an industry standard called "the rent to turnover rate" to convert that revenue to the imputed rental.

55. A major difficulty acknowledged by both valuers was the absence of reliable financial and other information. No financial records nor any other records were presented to them. They did not have the register of lodgers nor any other primary documents from which room tariffs, occupancy rates and other information could be extracted. As will shortly be noted, records of lodgers were available at court but neither party tendered them.

56. On their initial approach, both valuers used an occupancy rate of 50 per cent.

57. Mr Burton adopted an average room rate of $30 per night. Applying the occupancy rate of 50 per cent, a rate stated by the hotel operator, he calculated an annual income of $366,825. He applied the rent to turnover rate which he determined to be 20 per cent of turnover. On that footing, he calculated the rent for the hotel to be $73,365 per annum which he rounded to $73,000. At the re-hearing, Burton was not prepared to qualify that figure.

58. Mr Williamson's initial assessment of the hotel rental was very similar. He believed that the average room rate would have been $25 per night "up to perhaps $30" per night. He believed an occupancy rate of 50 per cent was likely. On that footing, the annual revenue was $305,687 (at $25 per night) or $366,825 (at $30 per night) which, of course, was Mr Burton's figure. Williamson then adopted a rent to turnover rate of 20-25 per cent, yielding a rental between, he said, $70,000 and $80,000. In his report he said that he believed that the hotel could have justified a higher rate per night and achieved a higher occupancy than 50 per cent. On that basis, he adopted an imputed rental of $75,000 per annum.

59. There was, therefore, little difference between the initial approaches of both Burton and Williamson on their estimate of the imputed rental for the hotel. It is common experience that reasonable valuers both applying correct valuation principle might reasonably disagree on value or rental income. It is fair to treat it as no more than a difference within an acceptable range.

60. Messrs Burton and Williamson also differed on their assessment of the shop rental. Mr Burton's assessment was that the three shops would yield an annual return of $38,750. Mr Williamson estimated it to be $45,000. At the conference before Master Norman, they agreed that the difference between them was within an acceptable range and neither was prepared to alter his opinion.

61. Thus, the imputed rental to which the capitalisation rate was to be applied was $108,750 for Burton and $120,000 for Williamson. Burton made a deduction of $5,825 for land tax but Williamson did not. It is appropriate to make a deduction for land tax in order to arrive at the net rental. The following table sets out the position of Messrs Burton and Williamson before the application of any capitalisation rate.

	Burton	Williamson
Hotel rental	73,000	75,000
Shop rental	38,750	45,000
	111,750	120,000
Less land tax	5,825	
	105,925	

If land tax is deducted from Mr Williamson, the difference between them narrows.

62. On being given the opportunity to take into account the evidence of Mr Stefanovic, Burton was not prepared to amend his valuation because he was not in a position to check that evidence. That is a reasonable approach. If that information had been available earlier, he could have called for records against which to check it. At the conference before Master Norman, Mr Williamson made a substantial adjustment to his initial assessment. Williamson said that, on the evidence of Stefanovic, he believed that the occupancy rate was, in fact, 75 per cent which increased the imputed rental for the hotel from $75,000 to $115,000. A re-calculation of his assessment of value resulted in the market value of $1,460,000.

63. In his evidence before Judge Lee, Williamson adopted an occupancy rate of 79 per cent. In doing so, he relied on the comment of Judge Lee in his preliminary reasons published on 22 December 2005 that the occupancy rate was 79 per cent. He used a rent to turnover rate of between 20 and 25 per cent to calculate an imputed rental for the hotel in the range of $95,000 to $140,000. He settled on an imputed rental of $120,000. To that he added the shop rental of $45,000 producing a total rental income of $165,000. He capitalised that sum at 11 per cent to reach a market value of $1,500,000. Williamson was critical of the methodology of using a rate per room as Mr Burton had done but it must be noticed that Williamson had himself used such an approach in his initial valuation.

64. The judge made two critical adjustments to the evidence of both Burton and Williamson. They concerned the average nightly room rate and occupancy rate. In making these adjustments, the judge revised his assessment of the evidence of Mr Stefanovic and amended his assessment of the occupancy rate.

Occupancy Rate

65. In his report, Burton had said that the hotel operator had informed him that the hotel had an occupancy rate of "between 50 per cent and 55 per cent" of which 90 per cent represented permanent occupants. He adopted a rate of 50 per cent. He added that an occupancy rate of 50 per cent was supported by what he called "industry parameters".

66. In his initial report, Williamson had adopted an occupancy rate of 50 per cent but had said that the hotel should have been able to achieve a higher rate. In that report, he referred to a report on rates of hotel occupancy prepared by Jones Lang Wootton and called "Hotel Market Commentary – Adelaide JLW Transact" ("the JLW report"). The JLW report was not attached to his valuation and was not tendered in evidence. However, at the re-hearing before Judge Lee, Williamson was permitted, over objection, to give evidence of the content of the report. That evidence should not have been admitted. Instead, the document should have been produced. The JLW report listed occupancy rates for the years 1995, 1996 and 1997. According to Williamson, the rate for hotels in the upper segment in 1995 was 65.8 per cent. Williamson's evidence was that the Plaza Hotel would have had occupancy rates between 50 and 65 per cent. Burton disagreed stating that 65 per cent in the JLW report could not be related to hotels of a poorer standard like

the Plaza Hotel. As will be noted shortly, the judge relied on the hearsay evidence of the JLW Report. He should not have done so. Apart from the fact that it was hearsay evidence, the evidence of both Williamson and Burton was that the JLW Report was expressed in general terms, a fact which only served to emphasise the fact that the report should have been produced so that its relevance and weight could have been assessed.

67. The judge criticised Burton's adoption of an occupancy rate of 50 per cent stating that it was inconsistent with the evidence of Mr Stefanovic which, on one view, suggested an occupancy rate of 79 per cent and because the evidence was that the hotel had a high proportion of permanent residents. However, as will shortly be noted, the judge himself resiled from a rate of 79 per cent after reconsidering the evidence of Mr Stefanovic.

68. The evidence of Mr Stefanovic on which the judge relied was as follows

You had some permanent residents.
Actually, most of the rooms were occupied by permanent residents.
Roughly how many.
I would say about 40 to 45 rooms.
This is permanent residents.
Yes.
What do you mean by permanent residents.
People that actually paid weekly, a weekly amount and actually lived in the hotel.
Were they on a weekly rate.
Yes, they were.

Q. How much did they pay at that time, that is about August 1997, per week for a single standard room.

A. As far as I remember, about $91 a room.

Q. And for a room with an ensuite.

A. $130 to $140 per week.

Q. Usually, around about August 1997, around about that time, usually what was the general occupancy of the hotel, in other words, roughly how many rooms on average were let out at any one time. Did that include permanent residents as well as non-permanent residents.

A. In percentage or - ?

Q. If you are able to give an approximate room number.

A. Let's say out of the 67 you said the hotel had probably about 15 rooms on an average.

Mr Stefanovic went on to say that on average one or two rooms were not fit for letting.

69. As the judge himself noted, the reference to 15 rooms in the last answer is ambiguous. It may have been a reference to casual guests, that is to say, guests who were not permanent residents. It was not responsive to the question "roughly how many rooms on average were let out at any one time?" In addition, Mr Stefanovic was not asked to express the occupancy rate in terms of a percentage. Finally, one important fact must be noted. It is that Fortson had discovered daily records of lodgers. However, they were not tendered. Neither Fortson nor Mr and

Mrs Jovanovic, who controlled Fortson, prepared any document which extrapolated from those primary records a summary showing either the number of rooms occupied or the tariff for each of those rooms. Such a summary would have been the best evidence of occupancy rates. The only evidence on that question is the relatively vague evidence of Mr Stefanovic, evidence which he gave in 2003, some six years or more after he had ceased employment in the hotel and some eight years after 1995, the year to which the evidence related. The judge, therefore, had sound reasons for deciding that he should not adopt an occupancy rate of 79 per cent or a higher rate for which Fortson was contending. He found that the occupancy rate was between 55 and 65 per cent.

70. It is apparent that the judge has relied on the evidence of Williamson as to the content of the JLW report when making that finding. Any reliance on the JLW report was misplaced given that the report was not tendered. The judge was not in a position to know what the report had said as to occupancy rates of hotels at the lower end of the market. The judge's rejection of Burton's evidence that the occupancy rate was 50 per cent appears to be founded on the evidence of Mr Stefanovic. I repeat, that was not the most reliable evidence especially given that the actual records of lodgers were available and were not tendered nor any summary of them. Among the inquiries that a prudent purchaser of the hotel would have made was to see the daily accommodation records. The failure of Fortson to produce the best evidence of the occupancy of the hotel calls into serious question its assertions and Williamson's opinions as to high occupancy rates. Having been instructed by Fortson, Williamson was in an excellent position to examine the records and determine the actual occupancy rate. He did not do so. The Jovanovics had told Burton that the occupancy rate was between 50 and 55 per cent and he adopted a rate of 50 per cent because it accorded with industry parameters. Williamson himself had initially adopted a rate of 50 per cent. His increase to 75 per cent and then to 79 per cent was based on the ambiguous and unreliable evidence of Mr Stefanovic. It was not based on accommodation records. In the absence of the accommodation records and any other reliable evidence, there was no justification for departing from the initial assessment of both Burton and Williamson that the occupancy rate was 50 per cent.

71. Mr Williamson's assessment of value is grounded on the evidence of Stefanovic. As Williamson himself said, the evidence of Stefanovic is crucial. However, there was nothing against which that evidence could be tested. Fortson had the accommodation records but did not tender them nor any summary of them. Williamson was Fortson's witness but he did not refer to those records.

72. Mr Williamson also sought to justify his imputed rental of the Plaza Hotel by reference to some figures obtained by Mr Burton concerning West's Private Hotel, another budget priced hotel in Hindley Street, but further from King William Street. Burton had ascertained that the average annual room rental rate for that hotel as at January 1995 was $1,760. Although the style of hotel was comparable, he had adjusted that room rate to $1,000 for the purpose of applying it to the Plaza Hotel for several reasons. The Plaza Hotel had twice the number of rooms. He also took into account subjective factors such as the quality of and fittings in the rooms, the very poor sate of repair of the property and associated

increased operating costs. However, without having inspected West's Hotel or having made any enquiries of his own, Williamson merely took Burton's ascertained figure of $1,760 per room and multiplied it by 67, being the number of rooms in the Plaza Hotel, in order to arrive at an imputed rental of $117,920, close to his ultimate figure of $120,000. In that respect Williamson's evidence cannot be treated as that of a valuer. He conducted a purely mathematical exercise without bringing into play any of the skills or expertise one would expect of a valuer.

73. All these factors call Williamson's assessment of occupancy rates and imputed rental into serious question and indicate that Burton's assessment should be preferred.

74. For these reasons, the judge's finding that the occupancy rate was 55 to 65 per cent is open to the criticism that it is too high, especially given that both Burton and Williamson had initially proceeded on the footing that the occupancy rate was 50 per cent. In my view, the judge should have found that the occupancy rate was 50 per cent. There was nothing which positively demonstrated that the initial assessments made by both Burton and Williamson were in error. However, it is not necessary to correct the finding because the judge, in fact, averaged the occupancy rates of 55 per cent and 65 per cent when calculating the imputed rental so that, as will later appear, even if one adopts the imputed rental as calculated by the judge, in the ultimate result the market value of the hotel is less than the price for which it was sold.

75. Both Mr Sallis and Mr Stevens, who appeared respectively for Fortson and the Jovanovics, attacked the finding that the occupancy rate was 50 per cent. Their submissions were without foundation. In any event, whatever force their submissions might have had is blunted by the fact that the accommodation records were in the possession of Fortson and of Mr and Mrs Jovanovic who failed to tender them or any extrapolation of them. Notwithstanding that the best evidence was in their possession, they failed to prove it.

The Average Room Rate

76. In adjusting the average nightly room rate, the judge again relied on the evidence of Mr Stefanovic. His evidence was that most of the rooms occupied each night were occupied by permanent residents at a rate of $91 per week ($13 per night) in the case of standard rooms and $130-140 per week ($18 to $20 per night) in the case of rooms with an en suite bathroom. There were 14 rooms with an en suite bathroom.

77. The judge then noted that the relatively small number of rooms occupied by casual lodgers were let a rate of $25 per night for one person to $35 to $40 per night for two persons in the case of standard rooms. In the case of rooms with en suite bathrooms the rate was $35 per night for one person and $40 to $50 per night for two persons. The judge assumed that the use of a room by three persons was uncommon. There is no attack upon these findings. Using those figures, the judge estimated that the average rate per room was between $15 to $20 per night and concluded that the estimate of Burton that the average rate was $30 per night

and the estimate of Williamson that the average rate was $25 to $30 per night were too high.

78. Mr Sallis and Mr Stevens both attacked the finding that the average room rate was $15 to $20 per night. Having examined that finding closely by a number of cross checks, I am satisfied that the judge was entirely justified in making the adjustment and in finding that the average room rate was between $15 and $20 per night. That is a direct consequence of the fact that the greater number of rooms were let at the cheaper rate to permanent residents. The average room rate would be higher only if there were a greater proportion of casual lodgers. The evidence is to the contrary.

79. For these reasons, there is no ground for disturbing the findings of the trial judge that the average room rate was between $15 and $20 per night. While the finding that the occupancy rate was between 55 per cent and 60 per cent is generous, it is not necessary to interfere for, in the end result, it will not affect the outcome.

The Rent to Turnover Rate

80. The next component in the calculation of the imputed rental is the rent to turnover rate. The judge explained that rate in this way in his reasons published on 30 November 2006:

> 24. [T]his rate reflects the costs which must be deducted from turnover to arrive at a rental to be imputed to the property. Those costs would include cleaning, light and power, laundry, telephone, repairs and maintenance, and fixed costs such as advertising, insurance, interest, and accounting and licence fees.
>
> 25. Obviously enough, the rent to turnover rate will vary from hotel to hotel. A hotel with a high ratio of permanent to casual residents will attract, generally speaking, a higher rate than a hotel with a low ratio of permanent to casual residents.

The valuers agreed that the industry standard was 20 per cent to 25 per cent of total revenue. Burton had adopted a rate of 20 per cent and was prepared to amend it to adopt a range of 20 to 25 per cent. He agreed with the proposition that the higher the percentage of permanent residents, the lower the cost per room.

81. Williamson's evidence was that the rate might be higher where there was a high proportion of permanent residents because the cost of servicing each room would be likely to be lower. He said that it is cheaper to run an hotel with permanent lodgers than with casual lodgers. He pointed to two hotels in the vicinity where the rate was 30 to 40 per cent. That evidence must be weighed with the fact that Williamson's initial valuation used the industry standard of 20 to 25 per cent. He did not amend that figure. The reference to a rate of 30 to 40 per cent was made in answer to a question from Mr McCarthy, counsel for the Bank. Later questioning disclosed that the rent at the two hotels to which Williamson had referred was an uneconomic rent for the lessee in that the rent was very high

having regard to turnover. As Burton pointed out the two hotels did not reflect the market position as to the rent to turnover rate. On examination, Mr Williamson's rate of 30 to 40 per cent is unrealistic and should be discarded.

82. The judge concluded that the rent to turnover rate in this case should be 25 to 30 per cent. He did not explain why he increased it to 30 per cent. It seems to be based on Mr Williamson's evidence which, as just explained, does not justify a rate of 30 per cent to 40 percent. There is no reason for departing from Burton's evidence at a rate of 20 to 25 per cent is reasonable, evidence which is consistent with Williamson's initial valuation. In my view, the judge erred in his finding and should have found that the rate to be adopted was 25 per cent, the rate consistent with the evidence of both Burton and Williamson. In the result, this is another error that does not affect the outcome of this appeal.

Capitalisation Rate

83. The capitalisation rate has a very significant bearing on the assessment of market value in that a variation of one or two per cent results in a substantially different value. The valuers disagreed on the capitalisation rate, Burton adopting a rate of 13.5 per cent and Williamson a rate of 11 per cent. (Mr Burton's valuation refers on occasions to a capitalisation rate of 13 per cent. He acknowledged in evidence that was an error and it ought to have read 13.5 per cent. His final assessment of value used a capitalisation rate of 13.5 percent.) The difference between the witnesses was the result of their differing views as to the likely purchaser of the hotel. Burton believed that the likely purchaser was an investor who would continue to use the property as a private hotel. In his view, any property investor would be very wary of the income producing potential of the hotel and the fact that Hindley Street had deteriorated as an entertainment venue. Williamson believed the purchaser would be a developer.

84. For the purpose of making his valuation, Burton examined sales of investment properties within the City of Adelaide. This was the only detailed evidence on which an estimate of the capitalisation rate could be made. He did not have regard to the sale of the Plaza Hotel in 1995. That was a proper view to take as the evidence suggests that it was not an arm's length sale. In his valuation he listed four properties which had been sold in 1995 and 1996 where the rental income was known and a fifth property subject to an option to purchase. They were:

5. **9-11 Hindley Street**

It was sold in August 1995 for $1,100,000. It was a retail and commercial property comprising a basement, ground floor retail space with upper floor commercial space. It had a total floor area of 1,560 square metres and a passing net income of $138,698, a yield of 12.61 per cent. It was common ground that it was located in a superior position to the Plaza Hotel and had secure tenants in place.

4. **12-16 Hindley Street**

It sold in March 1996 for $1,475,000. It is the former Miller Anderson store and two adjoining buildings. The total site area is 2,017 square metres with a building area of 6,613 square metres. At the date of sale, it had a holding income of $108,360 per annum, that is to say, a yield of 7.3 per cent. It was common ground that it was purchased for redevelopment and that it was located in a superior location to the Plaza Hotel. Like the property at 9-11 Hindley Street, it is much closer to King William Street.

5. **110-112 Franklin Street**

It sold in March 1996 for $1,055,000. The property comprises an older style commercial and retail building and provided lodgings for backpackers. At the date of sale it was fully leased to three tenants and had a passing income of $154,575 per annum, a yield of 14.65 per cent.

6. **125-127 Pirie Street**

It was sold in July 1996 for $845,000. It comprised a restaurant with a net lettable area of 625 square metres. It was leased for a term of 10 years with a right of renewal for a further 10 years, the rent being subject to annual review based on movements in the Consumer Price Index. The yield was 13.15 per cent. It was located in a good position in Pirie Street.

7. **88-90 Hindley Street**

This is a former Greater Union Cinema complex. It is almost opposite the Plaza Hotel. It has a gross building area of 330 square metres and a site area of 1,355 square metres. It was subject to an option to purchase for $720,000. The option price represented a price of $132 per square metre of the site area. At the time of Burton's valuation, the property had been vacant for some time. The site is some 200 square metres larger than the Plaza Hotel. The utility of this property lies in it being an indicator of the likely value of a development site at this location in Hindley Street. It is very comparable to the Plaza Hotel being a site of similar area and in the same part of Hindley Street, some distance from King William Street. It provides a kind of cross check on a comparable sales basis.

Burton had regard to the four sales and determined at page 17 of his valuation that the appropriate capitalisation rate was 13.5 per cent. In his view, the properties at 9-11 Hindley Street and 110-112 Franklin Street were "major benchmarks". Burton's capitalisation rate of 13.5 per cent realised a capital value of $762,407. From that sum, Burton deducted $50,000 to allow for repairs to the hotel and a further $55,000 as a letting up allowance. He also added back the present value of the rental surplus for one tenancy, namely, $866. This resulted in a capital value of $658,273 which he rounded up to $660,000. Burton regarded the Greater Union site as a development site and used it as a cross check against his valuation of the hotel by reference to the basic plot ratios of each site. On this basis his estimate of market value was $660,000. The market value of $660,000 equated to $142 per square metre for the site area which is comparable to the $132 per square metre for the Greater Union site at 88-90 Hindley Street.

85. In his initial report, Williamson did not examine capitalisation rates in any detail nor did he identify property from which comparisons could be drawn. His report baldly states:

is our view that capitalisation rates for investment city properties ranged from 10-12% in broad terms. Hotel related properties were considered a little more risky and therefore attracted a higher capitalisation rate.

there was interest at that time by investors to acquire properties which have development potential.

For an issue as important as the correct capitalisation rate is to the process of valuation in this case, that is a remarkably casual observation. It does not demonstrate any thorough consideration of the issue. It is, no doubt, a consequence of the fact that Williamson was not asked to prepare a valuation. His report contains no examination of factors affecting the determination of a capitalisation rate. Williamson's report stands in stark contrast to Burton's more thorough analysis. In addition, it must be noted that Williamson acknowledged that hotel related properties were a little more risky and had a higher capitalisation rate. In that state of the evidence, Burton's assessment of the capitalisation rate of 13.5 per cent is likely to be more reliable than Williamson's rate of 11 per cent. That is particularly so given that the yield on the site in Franklin Street was 14.65 per cent in respect of premises providing budget price accommodation similar to that provided by the Plaza Hotel. It was unlikely that the rate for an hotel such as the Plaza Hotel would be less than the rate for the commercial and retail property located at 9-11 Hindley Street, a property in a superior position to the Plaza Hotel. The yield on the Miller Anderson site must to be put to one side. That property is quite different from the Plaza Hotel. It is a much larger site and more suitable for re-development. In addition, the evidence suggested that there were factors affecting the income which, in turn, affected the yield from those premises. It is also a superior site to the site of the Plaza Hotel being much closer to King William Street. The property at 9-11 Hindley Street and the property at Franklin Street provided the range in which the capitalisation rate should be determined. Given the evidence of the capitalisation rate of comparable properties, Mr Burton's capitalisation rate of 13.5 per cent was a reasonable assessment.

86. In his evidence before Judge Lee, Williamson identified four possible kinds of purchasers, asserting that the likely purchasers would be in categories two or three.

1. Traditional investors who are risk averse and looking for a higher yield of between, say, 12 to 13% to 13.5%.
2. Investors with development experience who are prepared to take a risk to obtain a yield of between 11 and 12%.
3. Developers and/or entrepreneurs and/or builders, generally of some wealth and ability, who would be satisfied with a yield of 10 to 11%, with holding income a bonus.
4. Premium paying purchasers with 'blue sky visions' for property, who would see more potential than most buyers and who would be content with a yield of 9%.

He said that his marketing campaign would be aimed at persons in all four categories but especially those in categories two and three. As the judge noted:

> 41. Mr Williamson said that, whilst the full range within which the property would have been sold is 1.23 million to 1.77 million, buyers in categories 2 and 3 would have shown enough interest to pay:

Category 2 1.33-1.43 million (assuming a 75% occupancy rate)
1.375-1.5 million (assuming a 79% occupancy rate)

Category 3 1.45-1.6 million (assuming 75%)
1.5-1.65 million (assuming 79%)

A number of observations must be made about this evidence. First, it is not so much valuation evidence as the evidence of a sales consultant. As already noted, although Williamson had qualified as a valuer, most of his professional experience and, in particular in his recent experience, had been as a sales consultant. Secondly, it did not purport to be valuation evidence. Thirdly, it failed to have regard to the fact that at a public auction, the successful bidder has only to pay a little more than the previous bidder to purchase the property. In theory, this amount could be as little as one dollar more than the previous bidder. In reality, it will be more than that sum. The point simply is that Williamson's categories had little regard to that fact and lack utility. Fourthly, the occupancy rates on which he relied are substantially higher than the occupancy rates as found by the judge, a fact which further weakens the validity of his evidence. Finally, it must be noted that Williamson believed that investors who are averse to risk would look for a return between 12 and 13.5 per cent. That evidence re-inforces Burton's assessment of the capitalisation rate.

> 87. Williamson's assertion that a likely purchaser would be a developer can be tested with the benefit of hindsight. It is legitimate to use hindsight in this way. There has been no re-development of either of the Greater Union site or the Miller Anderson site. That points to the conclusion that Williamson has adopted an unduly optimistic view in believing that developers or entrepreneurs would have been likely purchasers. His evidence also fails to have regard to the fact that this site is not an attractive development site.
>
> 88. Given the difference of opinion on capitalisation rates, it was necessary for the judge to determine that rate. Instead of determining the rate which should be adopted by reference to the evidence, the judge undertook an unusual exercise. He said:
>
> > 69. I have reached the conclusion that the buyer of the hotel at the auction would have come from one of Mr Williamson's categories 1, 2 and 3, and that as between those categories the degrees of probability of that event occurring were as follows:

category 1 50%
category 2 35%
category 3 15%

70. As for the capitalisation rate for each category, I select 13.5% to represent category 1, bearing in mind that Mr Burton's range of 12.5% to 14.5% seemed to be reasonably based upon the sales of the income producing properties mentioned earlier in these reasons. I select 11.5% to represent category 2 and 10.5% to represent category 3. I conclude that, as an investor, a buyer from category 1 would have made the deductions deposed to by Mr Burton.

71. On that approach, the arithmetic for each of the categories is as follows:

category 1
$115,730 (hotel and shop rental) - $5825 (land tax) = $109,905
13.5% (cap rate) = $814,111 - $104, 134 (repairs and letting up allowance less rental surplus) = $709,977 (capital value)
2
(hotel and shop rental) ÷ 11.5% (cap rate) = $1,006,348 (capital value)
3
(hotel and shop rental) ÷ 10.5% (cap rate) = $1,102,190 (capital value)

72. Having established capital values for the categories, I now multiply each by the chance that the eventual buyer would have come from that category.

1 - $709,977 x 50% = $354,988
2 - $1,006,348 x 35% = $352,222
3 - $1,102,190 x 15% = $165,328
$872,538

73. The final figure needs to be rounded off to avoid contributing even further to the undesirable but unavoidable appearance of mathematical precision.

I am not aware of any instance where this kind of weighted average has been applied for this purpose. There is nothing in the evidence which justifies the approach. What the judge has done is, in fact, to determine an average of the valuations of Burton and Williamson. It is well established that a judge must not determine value by averaging the valuations of the valuers who have been called: *Commonwealth v Milledge [1953] HCA 6;* (1953) 90 CLR 157 at 160 to 161 where Dixon CJ and Kitto J described the process of averaging as "fallacious"; see also *Brewarrana Pty Ltd v Commissioner of Highways (No 2)* (1973) 6 SASR 541 at 578; *Anderson Stuart v Treleaven [2000] NSWSC 283;* (2000) 49 NSWLR 88 at 109.

89. Another reason why the approach is fallacious is that the capitalisation rate adopted by a valuer is that valuer's assessment of the likely purchaser and the risk inherent in the intended use of the land by that purchaser. It also reflects the general level of investment. The selection of the capitalisation rate is an exercise of valuation skill and judgment based upon the attributes of the property being valued and is determined by reference to the yield on that property.

90. For these reasons, the approach which the judge adopted is invalid. Instead of proceeding as he has, the judge should have adopted an appropriate capitalisation rate and applied it to the imputed rental. As he did not do so, this court must assess what the capitalisation rate should be.

91. The evidence as to capitalisation rates in Burton's valuation was not seriously challenged. All of the evidence points to the conclusion that the capitalisation rate of 13.5 per cent adopted by Burton is correct. Burton's is also the more thorough and more carefully analytical approach. In his evidence before Judge Lowrie, Williamson conceded that 13.5 per cent was a capitalisation rate consistent with Burton's view that this was an investment property.

Letting Up Allowance

92. It is standard valuation practice to make an allowance for any period in which rental income might be lost where there will be a gap in the tenanting. It is called "the letting up allowance". That could occur upon expiry of leases or upon a change in ownership if registered leases do not exist or by tenants quitting the premises. A prudent purchaser will make such an allowance, especially if that purchaser is a developer who does not have tenants ready and able to take possession upon completion of the development. As the leases for the shops were due to expire it was prudent to make the allowance. The allowance includes not only an amount for lost rent but also expenditure incurred in the process of finding tenants. That expenditure includes advertising and other marketing costs, commissions to an agent and legal fees.

93. Burton made a letting up allowance for rental income lost and the cost incurred in re-leasing the three retail shops. He made the allowance because the leases of the shops were due to expire. Burton made the allowance on the footing that it would take up to 12 months to find tenants for all three properties. He assessed the expenditure incurred in locating and installing new tenants as being 10 per cent of the rental income.

94. Burton calculated the letting up allowance to be $55,000. The calculation is in error. He had assessed the rental from the shops in a total sum of $38,750. One year's lost rental is, therefore, $38,750. To that must be added the costs incurred for leasing fees, $3,875. When the leasing fees are added to one year's rental income, the result is $42,625. The letting up allowance should be $42,625 and not $55,000 as calculated by Burton.

95. Mr Williamson did not make this allowance in his valuation but did so in his oral evidence. This is but another indication that Williamson's report was not a valuation but something more akin to a sales report.

96. Although Williamson allowed a six month period for the letting up allowance, the judge's calculation demonstrates that he accepted Burton's assessment. In my view the judge was correct to do so, although he should have reduced the allowance to $42,625. The sum of $42,625 must, therefore, be deducted after the capitalisation rate has been applied to the imputed rental.

Repairs

97. Burton made a deduction of $50,000 to allow for necessary repairs to the hotel. It was common ground that this hotel was in poor condition. At any one time two rooms for lodgers could not be used because of water or other damage. It

was not disputed that repairs were necessary if the hotel was to be sold to an investor. However, Fortson contended that a deduction for repairs should not be made if a developer were to acquire the site, demolish the building and erect a new building. The sum of $50,000 was accepted by the judge and is a reasonable sum to allow for repairs if a deduction for repairs is to be made.

The Assessment of Market Value

98. Burton's assessment of market value was $660,000. His calculations for the purpose of determining that value contain the errors already mentioned. First, although Burton had calculated the rental of the hotel to be $73,000 per annum he reduced it to $70,000 per annum. Secondly, he erred in his calculation of the letting up allowance. Once those two figures are corrected the market value is increased to $695,000.

Hotel income	73,000
Shop income	38,750
Total imputed income	111,750
Less land tax	5,825
	105,925
Capitalised at 13.5%	784,630
Less letting up allowance 42,625	
Repairs 50,000	92,625
	692,005
Add rental surplus	866
	692,871

Rounding those figures, the market value would be $695,000.

99. If the capitalisation rate is reduced to 13 per cent, the value is increased.

Total imputed income	105,925
Capitalised at 13%	814,807
Less letting up allowance 42,625	
Repairs 50,000	92,625
	722,182
Add rental surplus	866
	723,048

Rounding those figures, the market value would be $725,000.

100. This assessment can be checked by using the judge's figures adjusted for the reasons already given. The first task is to determine the imputed rental. For the

reasons already expressed, I am prepared to accept the judge's assessment of the occupancy rate of 55 per cent to 65 per cent, his average room rate of $15 to $20, and that the rent to turnover rate should be 25 per cent. On that footing the range for the imputed rental for the hotel will be calculated as follows:

At the rate of $15 per night and at an occupancy rate of 55 per cent, it is
15 x 65 x 365 x 0.55 x 0.25 = $48,932

At the rate of $20 per night and at an occupancy rate of 65 per cent, it is
20 x 65 x 365 x 0.65 x 0.25 = $77,106

The judge averaged the two figures and then added the shop rental as assessed by Williamson at $45,000. The approach is consistent with that adopted by both valuers and is appropriate to continue to use it. On that footing, the total of the imputed rental income for the hotel is $108,019. From that sum, it is necessary to deduct land tax of $5,825, resulting in a net rental of $102,194.

101. For the reasons already expressed, I adopt a capitalisation rate of 13.5 per cent. Applying that rate to the sum of $102,194 the result is $756,992, an amount less than that for which the hotel property was sold.

102. Even if a rent to turnover rate of 30% is adopted, the market value remains less than the price for which the hotel was sold. In that case, the higher income is 20 x 65 x 365 x 0.65 x 0.30 = $92,528. The average of that sum and the lower income is $70,729.75, say $70,730. The total income from the hotel and shops would then be $115,730. From that the land tax must be deducted to produce a net rental income of $109,905, which capitalised at 13.5 per cent is $814,111. That sum must be adjusted by deducting the cost of repairs $50,000, the letting up allowance of $42,625 and by adding the rental surplus of $866. That produces a market value of $722,352, an amount less than the price for which the hotel property was sold. If a capitalisation rate of 13 per cent is used, the ultimate market value is $753,664. Thus, even if Burton's assessment is adjusted in accordance with the amended findings of the trial judge and using either a capitalisation rate of 13.5 per cent or of 13 per cent, the market value of the property remains less than $800,000 for which the hotel was sold. On that footing, Fortson did not suffer loss.

103. For these reasons, the findings of Judge Lee as to the value of the hotel property should be set aside. Instead, the hotel was sold for more than its market value.

104. For all of these reasons the proceedings before Judge Lee were seriously flawed because the wrong question was answered. The question whether this court should remit the matter for re-hearing yet again for the purposes of determining market value or determine the issue itself is capable of clear answer.

For the reasons which follow, the court should determine the market value of the hotel property on the basis just expressed.

105. First, it has not been suggested by either party that the conduct of the case would have been any different if Judge Lee had identified the correct question. The kind of considerations that arose in *Stead v State Government Insurance Commission [1986] HCA 54;* (1986) 161 CLR 141 do not in any respect apply. In this respect, it must be noted that, after Mr Forster SC, counsel for the Bank, had contended that this court should determine market value, neither Mr Sallis nor Mr Stevens contended to the contrary.

106. This is a case where the issue of market value had been canvassed at length before Judge Lowrie. There was the *viva voce* evidence given before both Judge Lowrie and Judge Lee. In addition, there was the valuation of Mr Burton and the report of Mr Williamson. Further, although Judge Lee had posed the wrong question, much of the evidence led on the issue he identified was also germane to the question of market value. In the result, there was a considerable volume of evidence before Judge Lee on the question of the market value of the hotel property as is demonstrated by the preceding review of that evidence.

107. In his evidence before Judge Lee, Burton did not change his approach and gave his reasons for doing so. He adhered to the view that the market value of the hotel property should be determined on the basis set out in these reasons. In other words, in his view market value and the price obtained after properly advertising the property was the same. He also expressed opinions on Williamson's revised views. In his evidence before Judge Lowrie, Williamson had expressed his opinion on the question of market value. He departed from that evidence before Judge Lee especially in respect of occupancy rates, an issue germane principally to the issue of market value. For the reasons already given, he erred in reaching those conclusions.

108. One major difference between Burton and Williamson related to the capitalisation rate. The reasons for preferring the evidence of Burton have already been noted. He had made a more thorough analysis based on comparable sales. The rate adopted by Williamson before both Judge Lowrie and Judge Lee was the same, a rate of 11 per cent. His consideration of the question posed by Judge Lee merely re-inforced his view that 11 per cent was the appropriate rate. In short, all relevant information was before Judge Lee and is now before this court. Had Judge Lee addressed the correct question, he could have done so on the basis of the evidence which had been adduced before him. It should also be noted that although leave was given to recall Mr Taylor, he was not called. Although the appellant knew that the Bank had a valuation with an assessment higher than that of Burton, it did not apply to Judge Lee to call that valuer. Their evidence, if called, would have been relevant to market value. It would also have been relevant to the issue posed by Judge Lee.

109. In addition to all of these important considerations, regard must also be had for the fact that this is the second appeal to the Full Court and the fourth hearing in this action. Given the evidence available to it, this court should not put the parties to the cost and expense of yet another hearing.

Failure to Make Disclosure

110. I turn to the appellant's complaint that the Bank failed to disclose the fact that Mr Burton was an employee of the Bank at the time he gave his evidence on the re-hearing before Master Norman and Judge Lee.

111. When Mr Burton was initially retained, he was a valuer employed by Knight Frank (SA) Pty Ltd, a company engaged in a number of real estate activities. Its business included that of real estate agents and valuation. In 1999, he left Knight Frank (SA) Pty Ltd and was employed by Deutsche Bank and, later, by ABN AMRO Morgans. It was not until 2004, after he had given evidence before Judge Lowrie, that he became an employee of the Bank. The Bank is a large employer. It has more than 35,000 employees. He was employed in various departments of the Bank. At the time he gave his evidence, his role was entitled "Executive, Investment and Development Finance, Institutional and Business Services". He worked in what was called the Wholesale Funds Management Unit of the Bank. He was employed at the Bank's office in Pitt Street, Sydney. The department in which he worked at the time of the trial had no connection with the Bank's debt collection and recovery processes. Some time after the trial, Mr Burton was transferred to Colonial First State, a subsidiary of the Bank. In addition, after he had been employed by the Bank, Burton refinanced an existing mortgage by taking out a new mortgage with the Bank.

112. In November 2005, Mr Leydon, a solicitor employed by the solicitor for the Bank, contacted Mr Burton to make arrangements for him to give evidence on the re-hearing. Mr Burton then informed Mr Leydon that he believed that the action was at an end.

113. Mr Leydon and Mr McCarthy, counsel for the Bank, met Mr Burton in February 2006, prior to a conference before Master Norman, and to explain the procedure ordered by Judge Lee. Leydon and McCarthy checked that Burton had a copy of Practice Direction 46A, which prescribes guidelines for expert witnesses. Leydon's evidence is that he decided that it was not necessary for Burton to disclose that he was employed by the Bank. In his affidavit, Leydon said:

> 7. After giving the matter careful consideration, and consulting with Mr McCarthy, I reached the conclusion that in the circumstances, the identity of Mr Burton's employer was not relevant, and that there was no obligation on the Respondent or its legal representatives, or indeed on Mr Burton to specifically disclose that he was now employed by the Respondent.
>
> 8. In the course of that discussion Mr McCarthy also explained clearly to Mr Burton that even though he was called at trial as a valuer and not as an expert witness, Judge Lee was treating him as such by his reasons. I recall Mr McCarthy then referred to Practice Direction 46A and spoke to Mr Burton about a number of the requirements in that document. I recall Mr McCarthy advised Mr Burton to the effect that Mr Burton would have to disclose the identity of his then current employer if either:

He considered it was in any way relevant or significant to any opinions he would express or be asked about at the conference; or
He was asked by another party or a judicial officer about his employment.

> 9. I also recall that Mr McCarthy discussed with Mr Burton the relevant rules in relation to experts, and explained that Mr Burton's primary obligation was to assist the Court. Mr Burton did not express any concern about his employer or employment to me or to Mr McCarthy.

Leydon and McCarthy took similar action immediately prior to Burton giving evidence before Judge Lee.

> 114. Neither Rule 38 nor Practice Direction 46A expressly state that an expert who has a relationship with a party, other than that of being retained as an expert, is required to disclose that fact. However, expert evidence should be entirely objective and dispassionate. The expert should not have an interest of any kind in the litigation. The expert should be independent, that is to say, the expert should not have any kind of relationship with the party by whom the expert is called. The expert's evidence should be prepared by that expert independently or uninfluenced by that party. As Lord Wilberforce said in *Whitehouse v Jordan [1980] UKHL 12;* [1981] 1 WLR 246 at 256-257:

some degree of consultation between experts and legal advisors is entirely proper, it is necessary that expert evidence presented to the court should be, *and should be seen to be*, the independent product of the expert, uninfluenced as to form or content by the exigencies of litigation. To the extent that it is not, the evidence is likely to be not only incorrect but self-defeating. (Emphasis added)

There will be occasions when the expert will, for some reason, not be entirely independent of the party calling the expert. That does not have the consequence that the evidence of the expert is inadmissible. The issue is whether Burton had the competence to give this valuation evidence. Plainly, he was competent to do so by virtue of his qualifications and his inspection of the hotel property. His evidence was of probative value. If evidence is of some, albeit slight, probative value, it is admissible unless some principle of exclusion comes into play to justify withholding from the court's consideration: *Festa v The Queen [2001] HCA 72;* (2001) 208 CLR 593 at [14] per Gleeson CJ. There is no principle that disqualified Burton from giving evidence. The issues were examined at length in *FGT Custodians Pty Ltd v Fagenblat* [2003] VSCA 33, by Ormiston JA, with whom Chernov and Eames JJA agreed. Ormiston JA concluded at [29]:

desirable it may be, as a matter of common sense in the presentation of a party's case, that an expert witness be seen to be independent, there is therefore no authority requiring this Court to hold that an "interested" expert's evidence be rejected because of a "perception" that the witness might favour the party seeking to adduce that evidence.

I respectfully agree. In *Flavel v South Australia* (2007) 96 SASR 505, Bleby J also agreed with that reasoning and noted other decisions to like effect in the Supreme Court

and the Court of Appeal in New South Wales as well as in the Federal Court of Australia. I respectfully agree with the reasons of Bleby J for concluding that the decision in *Liverpool Roman Catholic Archdiocesan Trustees Inc v Goldberg (No 3)* [2001] 1 WLR 2337 should not be followed. As Bleby J noted, that decision was also disapproved by the Court of Appeal in *R (Factortame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)* [2003] QB 381. The fact that Burton was employed by the Bank did not mean that he could not be called as an expert.

> 115. Nevertheless, it is essential that an expert witness disclose any relationship with the party calling him. The interests of justice and fairness require no less. Disclosure is necessary so that the judge may determine whether any and, if so what, weight should be given to the evidence of the expert.
> 116. Burton was called as the valuer who had prepared a valuation on which the Bank had relied in 1997. He was called to defend his valuation and proffer other relevant evidence. He was giving evidence as to his opinion of the market value of the hotel premises. As such, it was expert evidence. Mr McCarthy erred in advising Burton that he was not giving evidence as an expert. Notwithstanding that Burton had not been employed by the Bank when he prepared the valuation, the fact of his employment by the Bank at the time of the hearing was a fact going to the weight of the evidence that Burton was to give. That fact ought to have been disclosed at the outset. Mr McCarthy, therefore, erred in giving the advice noted in paragraph 8 of Leydon's affidavit. He should have advised Burton to disclose that he was employed by the Bank. Such a disclosure would also have been fairer to Burton in that he would have had an opportunity to explain his position. His employment by the Bank would not have affected his evidence. The failure to make disclosure denied Burton that opportunity.
> 117. It is not entirely clear what relief the appellant seeks for the non-disclosure. Mr Sallis vacillated between an argument that the non-disclosure required that the appeal be allowed, the judgment of Judge Lee set aside and a re-hearing on the one hand and, on the other, an acknowledgement that the non-disclosure went only to the weight of the evidence. In his final submission, he seemed to contend for the former result.
> 118. The non-disclosure does not mean that this Full Court should order a re-hearing. The important fact is that Burton prepared his valuation when he was an independent expert and not employed by the Bank. He was doing no more than defending the conclusions he had reached in 1997, long before he was employed by the Bank. Furthermore, Burton had given evidence to Judge Lowrie at a time when he was not employed by the Bank. Before Judge Lee, he was repeating that evidence and defending the opinions he had earlier expressed. The court should proceed on the footing that the fact that Burton was employed by the Bank at the time he gave his evidence is a material fact which concerns the weight to be given to his evidence. At the same time, the court will have regard to the fact that the valuation was initially prepared long before Burton was employed by the Bank and that Burton had already given evidence to Judge Lowrie before, at a time when he was not an employee of the Bank. If Burton's employment by the Bank had been disclosed, it would have made no difference to the weight to be attached

to his evidence. The facts of the case are of a kind which do not require his evidence to be discounted. It is apparent from the review of the valuation evidence that the opinions which Burton reached were justified by the evidence. The failure to make full disclosure does not require a re-hearing. In the result, it does not affect the outcome of this appeal.

119. Mr Sallis submitted that, as the opinions of valuers were finally balanced, Judge Lee would have rejected Burton's evidence and relied on Mr Williamson's assessment of value. The submission fails for several reasons, not the least because it cannot be said that the issues between the valuers were finely balanced. As is apparent from the reasons above, the valuers were a long way apart in their respective assessments of value.

An Amended Judgment

120. The judgment of Judge Lee proceeds on the footing that Fortson suffered loss. As Fortson did not suffer loss, that judgment must be set aside.

121. The amount due by Mr and Mrs Jovanovic on the guarantee as at 3 March 2003 was $77,643.93, the amount as assessed by Judge Lowrie. I would give judgment for the Bank in the sum of $77,643.93 plus interest from 3 March 2003. It is appropriate to fix a lump sum. I would allow $25,000 for interest.

122. For these reasons, I would dismiss the appeal and allow the cross-appeal. I would set aside the judgment of Judge Lee and in lieu thereof order that Mr and Mrs Jovanovic pay the Bank the sum of $77,643.93 plus interest in the sum of $25,000. I would wish to hear the parties on the question of the costs of the hearings before Judge Lowrie, Judge Lee and of this appeal.

123. **BLEBY J.** I agree with the orders proposed by Debelle J and with his reasons. There is nothing I can usefully add to these reasons

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JOVANOVIC & ORS v COMMONWEALTH BANK OF AUSTRALIA No. SCCIV-03-802 [2004] SASC 61 (3 March 2004)

Last Updated: 14 March 2004

Court

SUPREME COURT OF SOUTH AUSTRALIA

Judgment of the Full Court

Hearing

13/10/2003 to 14/10/2003.

Catchwords and Materials Considered

MORTGAGES --- MORTGAGES AND CHARGES GENERALLY --- REMEDIES OF THE MORTGAGEE --- SALE UNDER POWER --- MODE OF EXERCISE OF POWER

REMEDIES OF MORTGAGOR

GUARANTEE AND INDEMNITY --- RIGHTS OF SURETY --- AGAINST CREDITOR

Appeal from a Judge of the District Court - respondent exercised power of sale over property pursuant to mortgage granted to secure a loan to the second appellant - where the respondent adopted a closed tender process, open only to the appellants and the former owners of the property - respondent issued proceedings in the District Court against the first appellants pursuant to a deed of guarantee whereby the first appellants guaranteed the financial obligations of the second appellant to the respondent - the appellants claimed that the respondent acted in breach of the duties it owed to the appellants as guarantors and mortgagor respectively in exercising its power of sale in relation to the property and failing to secure a proper price for the property - where the Judge found that the respondent had not acted in breach of its duties - whether the Judge correctly identified the common law, equitable and statutory duties the respondent as mortgagee owed to the appellants as guarantors and mortgagor respectively - consideration of the nature and extent of the duty in s 420A of the Corporations Law - whether the Judge was correct in concluding that the respondent did not act in breach of any duties owed to the appellants by purporting to exclude the business conducted on the property from the sale of the property - whether the respondent acted in breach of any of the duties it owed to the appellants in relation to the sale of the freehold title of

the property - if the respondent did act in breach of the duties it owed to the appellant whether the first appellants can recover from the respondent for the alleged loss of a newsagency business conducted on the property - consideration of the nature of the relief to which the first appellants as guarantors and the second appellant as mortgagor are entitled if the respondent is in breach of one or more of the duties it owed to the appellants - appeal allowed and the action remitted to the Judge in the District Court for hearing and determination of the market value of the property that would have been obtained but for the respondent's breach of duty.

- Corporations Law ss 420A, 1324(10);
- Law of Property Act 1936 (SA), s 55A;
- Residential Tenancies Act 1995 (SA);
- Transfer of Land Act 1958 (Vic), s 77;
- Property Law Act 1974 (Q), s 85;
- Real Property Act 1886 (SA), referred to.
- GE Capital Australia v Davis [2002] NSWSC 1146, applied.
- Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd [1976] VR 309;
- Commercial and General Acceptance Ltd v Nixon (1981) 152 CLR 491;
- Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd [2002] NSWSC 16;
- Standard Chartered Bank Ltd v Walker [1982] 3 All ER 938, discussed.
- Williams v Frayne (1937) 58 CLR 710;
- Buckeridge v Mercantile Credits Ltd (1981) 147 CLR 654;
- Kennedy v De Trafford [1897] AC 180;
- Pendlebury v Colonial Mutual Life Assurance Society Ltd (1912) 13 CLR 676;
- Citicorp Australia Ltd v McLoughney & Anor (1983) 35 SASR 375;
- Westpac Banking Corporation v Kingsland (1991) 26 NSWLR 700;
- Executor Trustee Australia Ltd v Deloitte Haskins & Sells (1996) 135 FLR 314;
- Gould v Vaggelas (1985) 157 CLR 215, considered.

Representation

Appellants: DOUGLAS DRAGAN **JOVANOVIC AND IRINI JOVANOVIC**
Counsel: MR R SALLIS - Solicitors: COSTI & CO

Appellant: FORTSON PTY LTD
Counsel: MR R SALLIS - Solicitors: COSTI & CO

Respondent: **COMMONWEALTH BANK** OF AUSTRALIA
Counsel: MR C MCCARTHY - Solicitors: ANDREW A BURDETT

SCCIV-03-802

Judgment No. [2004] SASC 61

3 March 2004

On Appeal from DISTRICT COURT (HIS HONOUR JUDGE LOWRIE)

(Full Court: Mullighan, Gray and Besanko JJ)

JOVANOVIC, JOVANOVIC AND FORTSON PTY LTD v COMMONWEALTH BANK OF AUSTRALIA

[2004] SASC 61

Full Court: Mullighan, Gray and Besanko JJ

1. MULLIGHAN J I agree that the appeal should be allowed for the reasons given by Besanko J and I agree with the orders which he proposes.

   GRAY J

Introduction

2. This is an appeal against a judgment following trial.

3. The **Commonwealth Bank of Australia (the bank) brought proceedings in the District Court against Douglas and Irini Jovanovic. The Jovanovics had guaranteed the obligations of Fortson Pty Ltd (Fortson) to the bank. The Jovanovics controlled Fortson. Fortson defaulted in its obligations to repay moneys advanced by the bank. After disposing of other securities the bank claimed $39,615.09 from the Jovanovics** pursuant to the guarantee.

4. The learned trial judge entered judgment for the bank on its claim against the **Jovanovics and dismissed a counterclaim brought by the Jovanovics and Fortson. The Jovanovics** and Fortson have appealed.

5. The primary issue at trial related to claims made by the **Jovanovics in their defence and by Fortson and the Jovanovics** in the counterclaim. It was the appellants' case that the bank had breached its equitable and statutory duties as mortgagee with respect to the sale of the mortgaged property. It was said that the bank had not taken all reasonable care in the sale of the mortgaged property. On appeal it was submitted that the judge had failed to properly consider or apply the provisions of section 420A of the Corporations Law.

Background Facts

6. In 1995 the **Jovanovics, through Fortson, purchased a property on which was conducted an hotel business from Slavko and Milorad Govedarica**

and Roclin Developments Pty Ltd (Roclin). The Govedaricas controlled Roclin. Fortson was incorporated for the purpose of the acquisition and was controlled by the Jovanovics'. The Govedaricas were said to be in financial difficulty.

7. The bank advanced $750,000.00 to Fortson to finance the purchase of the property. The property was situated in Hindley Street, Adelaide. The hotel was known as the Plaza Hotel. The business conducted at the property included the provision of short and long term accommodation and three retail tenancies. The hotel offered inexpensive accommodation. It was said that parts of the hotel were in a state of disrepair. A newsagency was also operated from the premises by the **'Jovanovics'**.

8. The evidence before the judge did not permit findings to be made about the ownership or operation of the hotel business. No prime records were produced about the occupancy rate or takings. No proper and complete accounts were produced. Limited secondary records were tendered, however, they did not provide a reliable basis for making findings. The evidence suggested that a management company had been involved in the operation of the business. There was apparently no lease of the property. There was no satisfactory evidence about ownership of the business or its operation.

9. At about the time of the 1995 sale an undisclosed side agreement was reached between the **'Jovanovics and the Govedaricas. Following the sale the Jovanovics'** were to hold a one-third interest in the property themselves and the remaining two-thirds interest on trust for the Govedaricas.

10. The bank took security over the property, a charge over the business of Fortson and guarantees from the **'Jovanovics'**. In 1997 Fortson defaulted and the bank took steps to realise its security.

Recovery Action by the Bank

Ms Barker

11. In October 1996 a bank officer, Cindy Helena Barker, took responsibility for the conduct of the bank file concerning the transaction between the bank, Fortson and the **'Jovanovics'**. Ms Barker kept detailed notes of her involvement and attendances. She had been employed by the bank for more than 15 years including a term in its asset management unit. Accepting Ms Barker's evidence in its entirety, the judge concluded:

> As appears from my earlier comments, Ms Barker gave evidence over a very long period and explained each step undertaken by the bank in endeavouring to obtain repayment of the moneys owed by Fortson. Ms Barker, very properly, diligently and fairly applied herself to this task and, in my opinion, was extremely patient in all of her dealings with Mr **'Jovanovic. I do not**

believe she overlooked any matter in any of her memoranda of her dealings with Mr Jovanovic's.

...

Ms Barker is an extremely experienced and competent bank officer. Effectively she assumed control of the **Jovanovics default in October 1996 and had control of the account until the Govedaricas tender was accepted some 10 months later. During this period she was continually discussing all issues of the default and the proposed bank actions with Mr Jovanovic's.**

12. On appeal counsel for the appellants did not challenge the judge's acceptance of Ms Barker's evidence. However, challenges were made to inferences and conclusions drawn by the judge.

The History of the Transaction

13. The history of the transaction as recorded by Ms Barker was summarised by the judge:

> Her notes and enquiries revealed that the Govedaricas and/or their company, Roclin Developments Pty Ltd ("Roclin"), had initially sold the Plaza Hotel to the **Jovanovics who had incorporated the company, Fortson, for this purpose. At that time there appeared to be a close friendship between the parties. It appeared that the Govedaricas at that time were in financial difficulties with another bank and consequently the sale to the Jovanovics evolved. Ms Barker mentioned it was not until quite late in the piece that the bank became aware of an agreement between the Govedaricas and the Jovanovics dated 15 November 1995 now referred to as the "secret agreement" which provided that if the Jovanovics and/or their company obtained sole legal title of the property pursuant to the contract of sale between Roclin and Fortson dated October 1995 the Jovanovics'** agreed that they would hold the property as to a one-third entitlement for themselves, and, the remaining two-thirds for the Govedaricas. It further provided:
>
> 'The **Jovanovic's**'s agree that notwithstanding any arrangement that involves their possession of sole legal title of the property, that they hold on trust for the benefit of the Govedarica's, ownership of the property

based upon the proportions of ownership outlined above.'

...

The bank had obtained details of the secret agreement prior to the eventual sale

...

Ms Barker said she was aware in the initial period that there were considerable negotiations between all the parties with the **'Jovanovics endeavouring to arrange finance to pay out the Govedaricas. It appeared that the Govedaricas owned a substantial car park adjoining the hotel property and that in itself had created financial difficulties for them. She was also informed that the Jovanovics had difficulty in taking over the day-to-day operations of the hotel from the Govedaricas and, consequently, this was a significant contributing factor to the ability of the Jovanovics'** to service the loan to the bank.

14. Ms Barker's review of the bank file disclosed the existence of an ongoing dispute between the **'Jovanovics and the Govedaricas. Earlier the bank had deferred recovery action against Fortson until litigation between the Jovanovics and the Govedaricas was resolved. However by 17 October 1996 Ms Barker recommended a recovery strategy. Proposals were to be sought from the Jovanovics'**. Cash flow budgets were to be requested. Attempts were to be made to clarify the legal position of the management of the Hotel.

15. On 21 November 1996 Ms Barker wrote to Fortson accepting a proposal that:

> . a lump sum payment of $20,000 ... be payable immediately
>
> . sufficient funds are to be credited ... to meet the Fixed Rate Term Advance instalments when due
>
> . arrangements to be reviewed in January 1997 following the conclusion of the trial scheduled to commence 14 January 1997.

16. These terms were not complied with by the appellants.

17. By January 1997 Ms Barker had formed the opinion that the **'Jovanovics were in a desperate financial position. At about this time Ms Barker was aware that the legal proceedings between the Jovanovics'** and the Govedaricas had been resolved and that negotiations were taking place

concerning the sale and purchase of the property. On 21 January 1997 Ms Barker was advised that the negotiations had been unsuccessful. She noted:

> This is a frustrating development. Recommend we now write to our client and advise that we require clearance of the excess ... otherwise the account is to be placed in reduction and mortgagee action commenced.

On 12 February 1997 Ms Barker noted:

> The method of sale by the CBA as mortgagee was discussed at length by [solicitor for the Govedaricas]. His clients are keen to avoid public auction. They state their reasons of (sic) being the cost which will be added to the CBA debt. It was again stated that the value of the hotel is $800,000. Our valuation is $1M dated 10/95. This was recently discussed with PVS [Property Valuation Service] who indicated the valuation is likely to be unchanged. Will now request PVS revalue on market and forced sale basis.

18. At about this time Ms Barker learnt that there was a dispute about who was entitled to possession of the property. This caused her to further note:

> This information casts a new light on Mr **Jovanovics** capacity to service our debt and it would appear that, notwithstanding that we have no knowledge of the newsagency profitability, he is unable to meet loan instalments from current income.
>
> ... We have given the **Jovanovics until 21/2/97 to put all accounts in order. The Jovanovics** have made an appointment with us for 13/2/97 and we await developments.

19. On 13 February 1997 a meeting took place with Mr **Jovanovic. The bank agreed to a private tender process between the Jovanovics and the Govedaricas. Both parties were required to agree to this process in writing by 21 February 1997. The bank advised Mr Jovanovic** that legal notices would be issued so that the bank would be in a position to act if a sale was not achieved. Ms Barker noted:

> If the first option of appointing an agent to sell the property goes ahead, we would wish to be able to be satisfied that the agent is reputable and property being marketed properly at a realistic price. Obviously, the Govedaricas could make an offer for the property and I would anticipate that **Jovanovic** would not sign any contract to them.

The Bank Revaluation

20. Following this meeting Ms Barker requested the bank's property valuation service to reconsider the bank's earlier internal valuation of the property. She also spoke with the bank's solicitor. Formal demand was made to Fortson for payment of the $68,078.15.

21. Ms Barker also requested that the internal property department of the bank revalue the security on both a market and forced sale basis. In late 1996 Ms Barker learnt that the **Jovanovics were conducting a newsagency business from the hotel premises. She formed the opinion that this appeared to be their sole source of income. The difficulties between the Jovanovics** and the Govedaricas left little cash flow to the bank to meet the ongoing obligations of Fortson.

22. The manager of the bank's property valuation service undertook the revaluation. A written memorandum of revaluation dated 14 February 1997 provided:

> As requested we have undertaken a revaluation of the above mentioned security. An inspection was conducted on 26/2/97. Reference is made to previous valuation dated 31/10/95.
>
> Security remains as described in the previous report. One vacancy has since developed. Nominal rental return is now estimated at $135,000. There appears to be some doubt about the Plaza Hotel rental ($96,000 pa) which has been disputed. One of the other leases (payment of $14,000 pa) is not at arm's length. Hotel rental does seem excessive although we have not been able to determine the level of trade. Allowing $75,000 pa for the hotel, total rental on a fully leased basis is put at $138,000.
>
> Building itself may require upgrading in order for it to conform with current fire regulations. We have not been able to confirm the extent of this as thorough inspection was not made possible. At the least external appearance and hotel foyer would stand some degree of updating.
>
> Market value will depend on the extent to which satisfactory leasing agreements are reached. Given our assessment of market rental, current valuation is $950,000. On a forced sale basis our valuation is $850,000.
>
> As a separate matter but subject also to a commercial lease arrangement hotel business would be worth about $200,000 ($150,000 on a forced sale basis).

Revaluation: Freehold (Lessor's Interest)

Market value	$950,000
Less Realisation Expenses	$ 40,000
Bank's Valuation	$910,000

Forced Sale Valuation: $850,000 less $35,000, $815,000.

Revaluation: Leasehold of Plaza Hotel

Market value	$200,000
Less Realisation Expenses	$ 10,000
Bank's Valuation	$190,000

Forced Sale Valuation: $150,000 less $8,000, $142,000.

> Comments
>
> We have been informed about proposals for the security that might add value if they were to happen. In our view unless major upgrading costs are envisaged nothing is likely to seriously challenge the basis of our valuation.
>
> At present entire site seems to be in need of a clean up. Hotel component has an unsavoury reputation while exterior of retail outlets and the area in front warrants attention. Additionally we have been informed that there are up to 35 permanent residents staying in the hotel who may be subject to the Residential Tenancies Act. It would seem that several items will need to be cleared up before any decision to purchase the site.

This internal bank valuation concluded that market value of the property was $950,000.00. The market value of the business was $200,000.00.

23. On 5 March 1997 the bank gave notice to Fortson alleging a breach pursuant to section 55A of the Law of Property Act 1936 (SA). Ms Barker wrote to the Jovanovics advising **that the bank was prepared to postpone a mortgagee sale for a period providing the Jovanovics** undertook to sell the property at a realistic price or arrange to refinance the above debts elsewhere.

24. On 7 April 1997 Ms Barker noted:

> It is unclear whether the Hotel business is managed under contract by the Govedaricas or whether no contract exists. Consider the latter is more likely.

We are aware that the Govedaricas maintain active and assertive legal representation in this matter.

Both Fortson and Govedaricas consider that no other party will be interested in purchasing the Hotel, outside of these two.

Forced sale valuation in hand for the freehold only does not allow much margin for selling costs if our debt is to be repaid in full.

In addition, the concept of an internal auction has been raised in the past by Mr **Jovanovic**. This would see sale by tender, open only to these two parties. The reason behind this request appears to be that each of these two parties appears to believe that CBA will sell the Hotel for the amount of its debt. Therefore if the CBA pays Agent or Receiver costs, the cost to purchase will be higher. Both parties want to purchase at the cheapest price.

Have discussed this with Legal ... . Of course our usual basis for setting a sale price is the valuation. Legal advise that if we wish, we could proceed along the internal auction course on the following basis:

- request each party write and state the amount they would be prepared to pay and the terms of settlement

- advise each party that CBA would have the option to refuse both tenders if the amounts offered were not at, or above a reserve price

- sell only if the winning tender is around the reserve mark.

Obviously we would not sell at a price that could not be supported by valuations.

Recommend we issue a [notice of sale] today. In view of the complications with the management aspect, recommend that we avoid public sale and instead attempt sale by the internal auction method. We would write to both parties as guided by legal, seeking their written expression of interest in purchase of the Hotel as a going concern, including price and terms. Response required within 7 days."

Independent Advice

25. Ms Barker was concerned that the bank's internal valuer had been unable to make a thorough inspection of the hotel. She was troubled about the nature of permanent residencies under the Residential Tenancies Act 1995 (SA). She was concerned the bank's valuation may not reflect the true position. She wished for more certainty.

26. On 2 May 1997 Ms Barker instructed Knight Frank to value the property. On 22 May 1997 the bank received the Knight Frank valuation. The valuation expressed the opinion that the market value of the property was $660,000.00. Market value was defined to mean:

> Current Market Value means the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and willing seller in an arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Knight Frank was of the view that the property would realize $560,000 on a forced sale. Forced sale was defined as:

> the price at which a property might reasonable (sic) be expected to be sold at the date of valuation, assuming that the sale is being negotiated by an anxious vendor or is being offered to the market with the power of sale being exercised by a mortgagee/receiver or manager, the purchaser is fully informed as to the nature of the property and the reason for the sale, the property has been fully exposed to the market during a short, intensive marketing programme, which may be less than an appropriate marketing period for a property of this nature in the current market and that no account has been taken of any additional bid by a special purchaser.

Knight Frank expressed concern over the uncertainty surrounding the hotel's operations and that there was virtually no secure short term income. Assumptions were made as to occupancy rate and rental income. Knight Frank did not value the hotel business.

The Process of Private Tender

27. On 22 May 1997 letters outlining a proposed tender process were forwarded to the **Jovanovics and the Govedaricas. The bank's tender documents made it clear that the bank was only offering the freehold property for the sale. The hotel business, the plant, fittings and equipment and the newsagency were not the subject of the tender. The bank sold the freehold property and nothing more. Both the Jovanovics and Govedaricas submitted tenders. The tender documents required the lodging of a deposit. The Govedaricas lodged a deposit. The Jovanovics** did not.

28. The **Jovanovics' business advisor informed Ms Barker that there would be difficulties in gaining approval to an application for finance. He considered that the Jovanovic's** proposal would be declined by all banks. However he thought it may be attractive to private investors. Ms Barker noted:

> Mr **Jovanovic's** prospects of obtaining finance appear remote. In view of deposit deficiency and incomplete tender recommend we decline this tender.

29. Ms Barker recorded the following observation with respect to the Govedaricas' tender:

> Proposal is for CBA (preferred lender) or another financier to lend $650,000. Have discussed with Darryl Royans (Snr Manager Approvals) and Colin Richie (Mobile Sales Force Unit). Colin strongly opposes the bank dealing with the Govedaricas due to his knowledge of their loan conduct when with BankSA (Asset Management Unit). Darryl has indicated that, with this in mind, he would not be inclined to approve the application.
>
> Recommend we decline the Roclin application for finance, under SMA signature.
>
> Roclin are in control of the accommodation business within the Plaza Hotel. There would appear to be some prospect of Roclin being able to raise finance. Tender and deposit provided are in order. The price offered is below PVS FSV but above KF FSV and market valuation, and is considered acceptable.
>
> Recommend we respond to Roclin along the lines that we will defer our decision on their tender until 5pm 20th June 1997. If evidence of formal finance approval is provided to this office by that time, their tender will be accepted. Exact wording of reply to be approved by Legal Department.

30. By 23 June 1997 a decision had been taken by the bank to seek further offers from the **Jovanovics** and the Govedaricas. Ms Barker noted:

> Decision has been made to:
>
> - seek a further offer from both parties supported by written evidence of irrevocable unconditional finance. This effectively provides the Govedaricas with the additional time they have sought, and also gives **Jovanovic** a further opportunity.

- set deadline for receipt of offers at 12 noon 4/7/97

- request a Receiver make a pre appointment inspection of the Roclin operated hotel (accommodation) business prior to 4/7/97. Recommend Tony Smith of Ernst and Young. We wish to obtain information on the trading of the business, and suspect that if the Govedaricas are not successful in their bid to purchase the Hotel, their co-operation may not be forthcoming. The information will be vital if the sale process is unsuccessful and a Receiver is appointed.

The Ernst & Young Advice

31. On 25 June 1997 the bank sought independent advice from accountants Ernst & Young. The bank's instructions to Ernst & Young included the following:

> A review of management agreements and any other documentation between the Company and Roclin Developments Pty Limited and any other relevant entities owned and operated by the **"Jovanovics"** and the Govedaricas.
>
> Determine the party with the operating rights for the Plaza Hotel business and if possible establish the viability (or otherwise) of the business operations.
>
> Your advice regarding realisation strategies that can be adopted by the Bank to maximise the return from this account."

On 4 July 1997 Ernst & Young provided a report which contained the following advice:

> On the basis of investigations and discussions carried out, our preliminary understanding of the position of the respective parties may be summarised as follows:
>
> ...
>
> 4.0 Options
>
> Notwithstanding the lack of documentation, we consider the following three options the most practical alternatives:
>
> 1. As the tender process is running, if one of the parties can confirm that finance is able to be independently obtained, then a sale of the property to this party is clearly the preferred option.

2. Extend the timeframe for either party to obtain finance. (The Bank should probably go straight to the market unless there is a reasonable opportunity for one of the parties to obtain finance in the next 4 to 8 weeks).

3. Appoint an agent and put the Hotel to the market.

4.1 Option 1

This is clearly the preferred option. Clarification of ownership of the chattels will however be required, particularly if the **Jovanovics** are the successful purchaser.

4.2 Option 2

If neither party is able to confirm finance by 4 July 1997, the Bank may consider extending the timeframe for obtaining finance for (say) a further 4 to 8 weeks. Both parties can be advised that should they fail to obtain finance, the Bank will be putting the Hotel to the market. In the meantime, the Bank should require that all rental monies from commercial tenants are forwarded to the Bank, including rent due by the newsagency. The Govedaricas should be informed that the Bank requires a weekly accounting of receipts and payments in relation to accommodation and that a minimum payment of $8,000 per month is required in respect to the accommodation receipts. In addition, all monies received the Govedaricas are to be banked into the PHPL account (which we are advised is the operating account for the hotel) maintained at the **Commonwealth Bank**.

4.3 Option 3

If it is considered that the prospects of finance being obtained by the two parties are remote, then the Bank should, after clarifying ownership of the chattels and the management arrangement, appoint an agent and put the Hotel to the market. In doing this, the Bank will require control of the receipts and payments as detailed in Option 2 above. If it is felt that the Govedaricas will not be remitting the appropriate monies to the Bank then the Bank should consider appointing an agent or a receiver to manage the Hotel providing the existing arrangement, if any, can be terminated. Consideration will also need to be given to an arrangement with PHPL, the alleged owner of the chattels on two grounds:

- rent for usage of the chattels; and

- an option to purchase the chattels either by the Bank prior to selling the property or a purchaser in a separate agreement.

We have asked Mr Govedarica to advise the details and value of the chattels located in the Hotel. He has advised that he believes the chattels to be worth $60,000 which is based on 35% to 40% of current cost. In our discussions with Mr Govedarica, he advised that he did not particularly wish to remove the chattels as he has no real use for them and therefore it is probably that a deal could be done with him for the purchase of the chattels.

4.0 Recommendation

...

If one of the parties is able to obtain finance and the valuations support the price offered, we recommend selling to that party as soon as possible. Further consideration of Options 2 or 3 outlined above should wait until receipt of documents evidencing arrangements between the parties. We will continue to pursue [solicitors for **Jovanovics** and Govedaricas] for the relevant documents and upon receipt, we will clarify the outstanding issues and provide you with our further advice.

32. On 8 July 1997 Ms Barker's diary notes summarised the position:

Sale of Plaza Hotel freehold

Deadline for lodgement of offers to purchase was 12 noon 4/7/97.

No offer was received from Doug **Jovanovic** as he was reluctant to pay up front broking fee of $10,000 to obtain finance approval required by CBA. On 7/7/97 ... Solicitor for Doug telephoned and again requested we allow Doug a further two weeks to obtain finance? This request was declined by the writer. An identical request had been declined 2/7/97.

... Solicitor for the Govedaricas called at this office 4/7/97 and spoke to Neil Smith SMCM and the writer. He stated that his clients' offer of $800,000 still stood, however they were unable to raise finance anywhere.

> CBA had declined to provide finance of $650,000 5/6/97.
>
> [Solicitor for Govedaricas] advised finance requirement had reduced to $620,000 and requested the bank reconsider its' decision. Settlement is offered in 7 days. The application has been completed and is awaiting decision.

33. The Ernst & Young advice identified three options. Critical to the advice was whether confirmation would be forthcoming by one of the parties that finance could be independently obtained. If there was not a reasonable possibility of one of the parties obtaining independent finance within four to eight weeks the bank should proceed "straight to the market". This would involve the appointment of an agent and "putting the Hotel to the market".

34. The bank appeared to accept this advice. Ms Barker noted that the Ernst & Young conclusion and recommendations were identical with the bank's existing strategy. Notwithstanding this position, by 14 July 1997, the bank had accepted the Govedaricas' offer.

35. It is to be observed that the first option identified by Ernst & Young, the preferred option, could not be advanced. Neither the **Jovanovics** nor the Govedaricas were able to confirm that finance was able to be independently obtained. In this event it was the advice of Ernst & Young that the hotel be put to the market. The bank did not do so. The bank sold the property to the Govedaricas through Roclin. There was no independent financier. The bank provided finance of $620,000.00.

36. As earlier observed the request by the **Jovanovics for an advance of $620,000.00 had been refused by the bank. The bank was aware that the Jovanovics could not obtain independent finance. The bank considered that the Jovanovic**'s financial position was dire. This had been known to the bank from late 1996.

Preliminary Conclusions

37. The judge made the following finding about the financial position of Mr **Jovanovic**:

> It appears that by March 1997 the financial plight of Mr **Jovanovic** was extreme particularly with his advice to the bank on 27 March 1997 that he was some four months in arrears with insurance premiums and neither he nor the Govedaricas were able to pay the same. The insurance company had threatened to cancel the relevant policies. The bank had been requested by the insurance company to pay the sum of $6,254.70 for outstanding arrears.

As a consequence the bank treated with one party only. There was no competitive tender process.

38. The sale to the Govedaricas provided further benefits to the bank. The bank retained their rights against Fortson and the **Jovanovics. The bank still had the benefit of the guarantees of the Jovanovics** and a registered charge over the assets of Fortson. The bank's new debtor was Roclin. The Govedaricas provided guarantees. The bank had been unable to resolve the difficulty over the identity of the owner of the business. If the owner was Fortson, the bank's registered charge provided security. If the owner was Roclin then the bank had a charge over that asset.

39. The bank provided more than 75% of the purchase price. The bank was anxious to exercise its powers of sale to protect its position. It decided in these circumstances not to follow its existing strategy or its independent advice. The sale in these circumstances was not an arms length sale.

40. The judge considered that the bank's conduct in regard to the exercise of the power of sale and in particular that of Ms Barker could not be criticised. He concluded:

> [Ms Barker's] actions can be summarised as follows:
>
> (1) She initially undertook a detailed review of the file and involved herself with long attendances upon Mr **Jovanovic** and his solicitor.
>
> (2) She caused the internal bank valuers to revalue the security.
>
> (3) She was concerned because of the legal issues that had arisen between the warring factions and lack of financial records and then sought -
>
> (a) An independent valuation of the property, and
>
> (b) Professional accounting advice on the hotel operations.
>
> (4) Armed with the internal bank valuation and the Knight Frank valuation and receiving supportive legal advice, she recommended the internal tender process as suggested by Mr **Jovanovic** and willingly participated in by both parties. The independent accountants who were requested by the back [sic] to endeavour to clarify this mire of deceitful transactions also suggested this course.
>
> (5) In the tendering process she was sympathetic to the **Jovanovics** making no issue with the lack of

> payment of a deposit, but rejecting the same because of the fact it could not be supported by appropriate funding.
>
> A private or internal auction by a mortgagee must always be closely scrutinised. Because of the inherent risks it should never be a recommended course of action. However, there will always be exceptions because of a factual matrix of circumstances. In this case, Ms Barker's opinion was the informal tender process between the parties was in the best interests of the bank, whilst not overlooking the interest of the **Jovanovics**. This opinion was also the preferred option of the independent investigative accountants. Her motives can be summarised as reasoned and careful to ensure that the bank obtained the best possible price for the property.

41. In reaching these conclusions the judge overlooked the advice of Ernst & Young that the bank should only proceed to deal with the Govedaricas or the **Jovanovics** if they had arranged independent finance. In the event that independent finance was not available the bank was advised to sell by public auction through an agent.

42. Ms Barker's approach was to proceed with the informal tender process and reach an agreement with the Govedaricas'. The judge concluded that this accorded with Ernst & Young's advice. This was incorrect. There was no private auction or competitive tender process in any real sense.

Statutory Duty

Section 420A

43. Section 420A of the Corporations Act 2001 (Cth) provides:

> (1) In exercising a power of sale in respect of property of a corporation, a controller[1] 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.

44. Section 420A was introduced following recommendations of the Australian Law Reform Commission.

- There should be a duty requiring receivers to take reasonable care in the exercise of their powers.

- In particular, the duty should be to take reasonable care in the management of property and, if the property is sold, to ensure that it is not sold at a price below the best price reasonably obtainable.

- The corporation should be able to bring an action for breach of duty.

- A guarantor of the liabilities of the corporation to the chargeholder which appointed the receiver should also be able to bring an action...

- The provision should extend to chargees who take possession and their agents as well as receivers.[2]

45. The interpretation of section 420A is assisted by considering the court's approach to comparable provisions in two State statutes.

46. Section 77 of the Transfer of Land Act 1958 (Vic) contained a statutory duty to be complied with by mortgagors when selling mortgage property. In Henry Roach (Petroleum) Pty Ltd[3] Lush J observed[4]:

> In my opinion s.77 must be regarded as containing a statement of the obligation of the mortgagee in effecting a sale. It sets out as a matter of language two requirements cumulatively, a requirement of good faith and a requirement that regard shall be had to the interests of the mortgagor, grantor or other persons. The effect of its words is to bring together the concepts of an obligation to act in good faith and an obligation akin to an obligation to exercise care in much the same way as they are blended in the dissenting judgment of Menzies, J. in Forsyth v Blundell, supra, at (C.L.R.) p. 481, and in that of Salmon, L.J., in the Cuckmere Brick Co.'s Case, at (Ch.) p.966. I have likened the statutory requirement of regard to a requirement of care deliberately because I think it is impossible to distinguish in this context between having regard to the interests of another and taking care to protect the interests of that other.
>
> A mortgagee in exercising his powers is entitled to give first consideration to his own interests, a concept which is consistent with having regard to the interests of others or with taking reasonable care to protect the interests of others, what is reasonable being assessed in the light of the fact that not only is the mortgagee entitled to give

his own interests first consideration, but also that the reason for the existence of the power is to protect those interests.

47. In Commercial & General Acceptance Ltd v Nixon[5] the High Court considered a breach of a statutory obligation imposed by section 85 of the Queensland Property Law Act 1974. Mason J observed:

> There are a variety of reasons to sustain this [statutory] liability. The power is exercised primarily on behalf of and for the benefit of the mortgagee by his agent in whose selection the mortgagor has no say. The agent acts in accordance with the instructions of the mortgagee and has no independent discretion to exercise except in so far as the mortgagee may choose to leave arrangements for the sale in the hands of the agent. It is not unfair or unreasonable in this situation that the mortgagee should have the responsibility for the taking of reasonable care to ensure that the market value is obtained, including the responsibility for adequate advertising of the sale. He should satisfy himself that the property has been advertise in accordance with his instructions -- that, after all, is what a prudent vendor would do in the circumstances.
>
> The appellant is a finance company, no doubt experienced in the sale of properties. The class of mortgagees generally consists of institutional lenders experienced in the sale of property and to a lesser extent of small investors who for the most part are inexperienced. Unquestionably the duty is more easily discharged by the former than by the latter. But it is not unreasonable to require mortgagees generally, whether experienced or not, to bear the responsibility of seeing that adequate steps are taken to ensure that property is sold at the market value.
>
> ...
>
> ... The duty imposed by the subsection is specific. It requires "reasonable care" to be taken "to ensure" that the property is sold at the market value; it is not a mere duty to take reasonable care in a general sense. In this context the concept or standard of "reasonable care" is not satisfied by the mortgagee's delegation of the function to a real estate agent reputed to be competent. In the circumstances the standard of reasonable care expected of the mortgagee extends to the making of such arrangements as will ensure that the sale is properly advertised.[6]

Aickin J commented:

> The relationship of mortgagor and mortgagee is more than that of contract, the nature of the relationship having been worked out by the Court of Chancery, though now mostly, but not exclusively, contained in the express terms of the mortgage instrument or in statutes. The power of sale is an essential part of the mortgagee's security but it is not to be exercised exclusively in his own interest without regard to the interests of the mortgagor by directing attention exclusively to the recovery of the mortgage debt, interest and expenses rather than obtaining the market value of the property as at the date of the sale.
>
> It must be borne in mind that a mortgagee is not a trustee, nor is his position similar to that of a trustee. A mortgagee has for his own protection a power of sale but in its exercise he must not sacrifice the interests of the mortgagor or of subsequent incumbrancers. If his agent is negligent in the conduct of the sale he may recover any loss suffered by him but he recovers on his own account, not on account of the mortgagor, and could not claim more than his own loss. As a matter of policy these considerations demonstrate that the mortgagee is in a very different position from a trustee and he should be responsible for his agent's negligence in so far as it affects the mortgagor, an obligation for which he would be entitled to an indemnity from his agent.[7]

Brennan J reasoned:

> What does the duty oblige the mortgagee to do? The duty, to be performed in the exercise of a power of sale, extends to the steps to be taken to attract potential buyers for the property, the negotiations for sale, and the settling of the terms of sale. Ordinarily a vendor of property engages others whose professional or business skills equip them to perform these tasks and who, by taking the appropriate steps, ensure a sale of the property at market value.
>
> A question therefore arises as to whether the statutory duty is performed if agents are appointed to take the steps appropriate to ensure a sale at market value and care is taken to appoint competent agents, or whether the statute requires that the appropriate steps be taken, though the mortgagee may appoint another to take them on his behalf. The duty is defined in terms which look

> to the result of its performance -- a sale at market value -- and the phrase "reasonable care to ensure" describes what is to be done to effect that result. The duty relates to the acts which are to be done, not to the appointment of a person to do them. I would therefore construe s. 85(1) as imposing upon the mortgagee a duty to do what ought reasonably to be done to ensure a sale at market value, though he is at liberty to perform the duty by the hands of others. If an omission is made in doing what ought reasonably to be done to ensure a sale at market value, the duty is not performed, and it is immaterial that the omission was made by another upon whom the mortgagee relied to do it. Although it may have been entirely reasonable -- or even necessary -- for the mortgagee to rely upon another to do the omitted act, that circumstance does not establish that the mortgagee's duty was performed.[8]

48. Section 420A imposes no lesser duty than that contained in section 85 of the Queensland Property Law Act. Section 420A may even be said to impose a higher duty as the statutory obligation is to take all reasonable care.

49. In Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd & Ors[9] Campbell J observed:

> In deciding whether there has been a breach of s 420A, a court looks at the process that a controller of property of a corporation has gone through in selling that property. The enquiry 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 s 420A, 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.

50. These remarks are apposite. Pursuant to section 420A a consideration of the conduct of the bank involves an analysis of the process used to sell the property. It is unnecessary for the court to come to a conclusion as to whether market value was in fact obtained. However that conclusion will be relevant to the question of final relief.

A Comparison to the Equitable Duty of Good Faith

51. In Nixon[10] the High Court discussed the duty of good faith and compared that duty with the statutory duty created by the Queensland statute. Brennan J observed:

> The duty of a mortgagee exercising a power of sale has been formulated sometimes as a duty to exercise the power in good faith, sometimes as a duty to take reasonable precautions to obtain a proper price. The divergent strands of authority were referred to in Forsyth v. Blundell and in Australia and New Zealand Banking Group Ltd. v. Bangadilly Pastoral Co. Pty Ltd. In both cases it was found unnecessary to decide between the formulations.
>
> ...
>
> In Queensland, whence the present appeal has come, the legislature has intervened by enacting s. 85(1) of the Property Law Act 1974 (Q.):
>
> It is the duty of a mortgagee, in the exercise after the commencement of this Act of a power of sale conferred by the instrument of mortgage or by this or any other Act, to take reasonable care to ensure that the property is sold at the market value."
>
> The balance of opinion in this Court accepts that a duty to take reasonable precautions to obtain a proper price imposes a more onerous duty upon a mortgagee than a duty to act in good faith, the duty to act in good faith requiring 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 (see Forsyth v Blundell, per Walsh J. (94) and Mason J. (95); Pendlebury v. Colonial Mutual Life Assurance Society Ltd. (96).) Menzies J. expressed a dissenting view in Forsyth v. Blundell when he said (97): "To take reasonable precautions to obtain a proper price is but a part of the duty to act in good faith" though his Honour immediately declared the duty to fall short of the standard which the mortgagee, as a shrewd property owner, would be likely to adopt if the property were his own.
>
> It follows that the statutory duty, which appears to reflect some of their Lordships' language in Cuckmere Brick, is more onerous than a duty to act in good faith. If a breach of the statutory duty is established, as Connolly J. found and as the Full Court affirmed, it is

> unnecessary to define the limits of the duty to act in good faith or to determine whether the mortgagee's duty would be so limited if it were not for the statute. The respondent mortgagor sued and recovered a judgment upon a statutory cause of action, and the equitable obligation of the appellant mortgagee was not in issue. The extent of the statutory duty is to be ascertained from the terms in which it is expressed, aided by a consideration of those cases in which the same class of conduct as that complained of in the present case has been relied on to sheet home liability to the mortgagee.

52. If a breach of the statutory duty is established in the present case, it is unnecessary as it was in Nixon, to define the limits of the duty to act in good faith or to determine whether the mortgagee's duty would be so limited if it were not for the statute.

The Trial Judge's Approach

53. The trial judge referred to section 420A on several occasions in his reasons. However, he did not analyse the provision. In the course of his reasons he said:

> In 1988 The Harmer Report was released in an attempt to elucidate the Australian position. This report specifically refrained from using the term "market value" as this could be a "costly and difficult for partly manufactured goods or products with a limited market" (Symes 51). This has further been suggested that to couch this duty in "market value" or "best price possibly obtainable" is to place the duty in an objective standard. This report led to the introduction of section 420A Corporations Law 2001 which introduced a duty to take "reasonable care" when exercising the power of sale. From this legislation, it is stipulated that there is no correct method of sale, with an absence of statutory requirement for such. In this legislation, in deciding if there has been a breach, the court will examine the process the receiver goes through in selling the property (Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd [2002] NSWSC 16). In this case it was held that "any departure from reasonable standards must be so serious as to be properly characterised as unconscionable, in order to render the mortgagee accountable". In fact, in Cape v Redarb Pty Ltd (No 2) (1992) 10 ACLC 1, 272, it was held that under section 420A, "as a consequence of the attitude of hostility and distrust.... So clearly displayed" it put the receiver in a 'no-win' position and is (sic) entitled to act upon his or her own advice a little more than is normal.

He then observed:

> The immediate question to consider is in carrying out her duties did Ms Barker and thus the bank act in and about the manner of the execution of her duties and in the eventual exercise of the power of sale in good faith? Did the bank by its actions show a calculated indifference or reckless disregard to the rights of Fortson and the **Jovanovics**?

54. It is apparent that the trial judge confused the equitable and statutory duties. The judge's enquiry was whether the bank had showed a "calculated indifference or reckless disregard" to the rights of Fortson and the **Jovanovics**. As earlier observed, the judge's reasons do not disclose any consideration of the terms of section 420A. The judge did not enquire whether the bank took reasonable care to obtain not less than the market value of the property. The judge did not consider whether the bank took all reasonable care to sell the property for the best price that was reasonably obtainable having regard to the then existing circumstances.

55. Counsel for the bank contended that the trial judge had found that the bank through Ms Barker had taken all reasonable care. It was said that it could be inferred that the judge had paid proper regard to the terms of section 420A. It is correct to observe that the judge concluded that he did not believe it was possible to criticise Ms Barker in any way for her handling of the default file. However this conclusion was reached when considering issues of good faith, calculated indifference and reckless disregard.

56. The trial judge erred in his interpretation of section 420A. He misapplied the section to the facts of the case before him. He treated the duty under section 420A as one of good faith.

To Whom is the Duty Owed

57. Bryson J in GE Capital Australia v Davis[11] observed that section 420A(1) spoke with "Delphic simplicity" by specifying what a "controller" must do but made no reference to the consequence of a failure to comply with the statutory duty. Bryson J took the view that the statutory duty was only owed to the corporate owner of the property.

58. Bryson J considered that guarantors were protected in equity. Reference was made to the remarks of Dixon J in Williams v Frayne[12] and Brennan J in Buckeridge v Mercantile Credits Ltd[13]. He then concluded:

> These authoritative statements appear to me to have the effect that the surety may complain of anything of which the debtor may complain, and has further rights where the value or realisation of the security has been diminished by the creditor's neglect or default. What is meant by neglect or default is not further defined by the

> authorities, but it gives more protection than was available to the debtor under Pendlebury. The guarantor has even greater protection and may be completely discharged if the creditor fails to obtain effective security which is available as in Wulff v Jay, or varies the terms of the loan or security without the guarantor's concurrence. Where subs420A(1) applies I am of the view that it should be applied as a fair representation of the standard of neglect or default referred to by Dixon and Brennan JJ. If the guarantors show that the mortgagors would, if they made a claim, be entitled to a remedy under subs420A(1), the guarantors are, in my opinion, entitled to a similar remedy by way of an equitable defence to the claim against them, subject to the provisions of the guarantee. [14]

59. In Standard Chartered Bank v Walker[15] when addressing the question of equitable duty, Lord Denning observed:

> So far as the receiver is concerned, the law is well stated by Rigby LJ in Gosling v Gaskell [1896] 1 QB 669, a dissenting judgment which was approved by the House of Lords (see [1897] AC 575, [1895-9] All ER Rep 300). The receiver is the agent of the company, not of the debenture holder, the bank. He owes a duty to use reasonable care to obtain the best possible price which the circumstances of the case permit. He owes this duty not only to the company (of which he is the agent) to clear off as much of its indebtedness to the bank as possible, but he also owes a duty to the guarantor, because the guarantor is liable only to the same extent as the company. The more the overdraft is reduced, the better for the guarantor. It may be that the receiver can choose the time of sale within a considerable margin, but he should, I think, exercise a reasonable degree of care about it. The debenture holder, the bank, is not responsible for what the receiver does except in so far as it gives him directions or interferes with his conduct of the realisation. If it does so, then it too is under a duty to use reasonable care towards the company and the guarantor.

60. In Nixon,[16] Brennan J considered the position of those on the "mortgagor's side" when considering the issue of statutory duty he said:

> ... On the other hand, the statute seeks to protect the interests on the mortgagor's side, not by requiring an attempt to obtain the best price which could be obtained for the property, but by requiring the taking of reasonable steps to obtain its market value.

61. The terms of section 85 of the Queensland statute do speak of "a person damnified by the breach of duty" having a "remedy in damages against the mortgagee exercising the power of sale". Section 420A contains no comparable provision.

62. However section 420A is remedial in nature and if any ambiguity exists the section should be given a beneficial construction. As earlier observed there is ambiguity arising from the fact that the section does not provide for the consequences of a failure to comply. The section is fairly open to a liberal interpretation. To allow a guarantor to have the protection of the statute does not strain the language of the statute. Such an interpretation is fairly open on the words used. The position of a mortgagor, a mortgagee and a guarantor are inextricably linked. This is well demonstrated in the present case.

63. The section operates to protect the interests on the mortgagor's side. In these circumstances the statutory duty operated to protect both Fortson and the **Jovanovics. The bank owed the same statutory duty to the Jovanovic's** as guarantors as it did to Fortson as the corporate debtor. However, if the view of Bryson J is to be accepted, a guarantor would have rights in equity that mirror the statutory right and would entitle the guarantor to a similar remedy by way of an equitable defence subject to the provisions of the guarantee.

The Application of Section 420A in the Present Case

64. The following conclusions can be drawn about the process of sale in the present case.

- The process followed was contrary to the usual practice of the bank.

- The process followed was contrary to the advice of Ernst & Young:

. the property did not go to the market.

. the property did not go to a competitive tender.

. there was no independent financier

. the sale price was not supported by "valuations"

- The bank negotiated with only the one possible purchaser.

- The bank did not conduct an internal auction.

- The sale could only proceed because the bank was prepared to act as a financier to the Govedaricas. Given their previous difficulties, the lack of proper information about the running of the hotel business and the failure to identify the owner of the business, the bank did not test the market.

- The transaction provided the bank with particular benefits. It received $180,000.00 cash, a new debtor in Roclin and further guarantors (the Govedaricas). It retained

security over the freehold and probably resolved the ambiguity over the ownership of the business.

- The transaction was not an independent arms length transaction.

- The sale was for a consideration of $800,000.00. This was $110,000.00 less than the bank's internal revaluation of $910,000.00.

- The independent valuation from Knight Frank did not resolve the major uncertainties identified in the internal bank valuation.

- Faced with conflicting valuations the bank did nothing to resolve the differences.

- Doubts over the ownership of the business were an impediment to sale. The bank failed to resolve these doubts. The bank could have approached the court either on a possession summons or for a declaration. It did not do so.

65. The bank acted in breach of its obligations under section 420A. The bank breached its statutory duty to both Fortson and the **Jovanovics**. On the evidence before the trial judge there was a significant difference of view about market value. The bank's internal valuer and Knight Frank both provided contingent valuations. One major uncertainty related to the ownership of the business conducted on the premises. Given the different valuations, the obligation of the bank was to obtain the best price having regard to the circumstances existing when the property was sold.

66. The bank did not engage in a competitive tender. There was no competition. There was only one effective bidder. Further, the sale was not at arms length. The bank provided finance for more than three-quarters of the purchase price. Without the bank's support the Govedaricas would not have been able to purchase the property. The bank only supported the one bidder. The process followed was against the advice of Ernst & Young.

67. As earlier observed the **Jovanovics** were entitled to the protection of section 420A. They were entitled to pursue their counterclaim. Fortson was entitled to advance its counterclaim. Given the bank's breach of statutory duty the judgment on the bank's claim should be set aside.

Conclusion

68. For these reasons this appeal should be allowed. The orders of the trial judge should be set aside. The action should be remitted for further consideration to determine what relief, if any, the parties are entitled to in respect of the claim and counterclaims.

69. BESANKO J: This is an appeal from orders made by a Judge of the District Court after a trial in that Court. Mr Douglas **Jovanovic and Mrs Irini Jovanovic and Fortson Pty Ltd have appealed to this Court against the orders made by the Judge. Except where I need to refer only to Mr Jovanovic, I will refer to those parties as "the Jovanovics" and "Fortson"**

respectively. The respondent to the appeal is the Commonwealth Bank of Australia ("the Bank").

70. In the action, the Bank sued the **Jovanovics** on a guarantee for the sum of $39,615.09. The execution of the guarantee, the service of relevant notices under the guarantee, the calculation of the amount claimed under the guarantee and the failure to pay that amount were not in dispute.

71. The main issues at trial were those raised in the defence filed by the **Jovanovics, and in the counterclaim filed by the Jovanovics** and Fortson against the Bank.

72. At all relevant times, Fortson was owned and controlled by the **Jovanovics. In November 1995 Fortson purchased a property at 83-89 Hindley Street, Adelaide, in the State of South Australia ("the property"). The purchase was financed for the most part by a loan provided by the Bank. The Bank took various forms of security to secure repayment of the loan, including a mortgage over the property under the Real Property Act 1886 (SA) and a registered mortgage over the undertaking, property and assets of Fortson. It also obtained a guarantee from the Jovanovics**. Fortson failed to make timely repayments of the loan and the Bank took steps to claim the amount it was owed and to enforce its security. In July 1997 the Bank sold the freehold title of the property.

73. In the action in the District Court, the **Jovanovics claimed in their defence that the Bank, in exercising its power of sale in relation to the property, acted in breach of the duties it owed to the Jovanovics and Fortson respectively, and failed to secure a proper price for the property. The Jovanovics claimed that they had an equitable set off which defeated the Bank's claim against them under the guarantee. The counterclaim by the Jovanovics and Fortson contained similar allegations of breach of duty by the Bank together with claims for various monetary amounts representing loss said to have resulted from the Bank's breaches of duty. One such claim was for the loss of a newsagency business which had been conducted on the property by the Jovanovics** from 1995 to 1998.

74. The Judge found that the Bank owed duties to the **Jovanovics and Fortson, but that it had not acted in breach of those duties. He entered judgment for the Bank against the Jovanovics** for the amount then owing under the guarantee ($77,643.93) and made an order for costs in favour of the Bank. Although he made no specific order, the Judge said in his reasons that he dismissed the counterclaim, and no point was taken about the absence of a formal order in that respect.

75. Fortson was deregistered on 11 September 1998. On the hearing of the appeal the Court was told that the company had since been re-registered and that its deregistration was not an impediment to the company's ability to pursue the counterclaim and the appeal to this Court.

The Background Facts

76. At all relevant times, there has been a private unlicensed hotel on the property. The hotel consists of some 67 rooms over three levels and is known as The Plaza Hotel. There are also three retail shops in the building and these shops front onto Hindley Street, Adelaide. In 1997, two of the retail shops were operating, one as a newsagent and the other as a games shop. From 1995 to 1998, the **Jovanovics** conducted the newsagency business. Parts of the building on the property were in poor condition and in need of repair.

77. In about 1988 or 1989, the **Jovanovics** met and became friends with Mr Slavko Govedarica and Mr Milorad Govedarica. I will refer to the latter two as "the Govedaricas". At all relevant times, the Govedaricas owned and controlled a company called Roclin Developments Pty Ltd ("Roclin"). Until late 1995, Roclin owned the property. Roclin, or another entity controlled by the Govedaricas, operated the hotel business on the property.

78. Roclin, or the Govedaricas, also owned a carpark at the rear of the property. They had borrowed moneys from the State Bank of South Australia and were having trouble making the necessary repayments. In late 1994 or early 1995 the Govedaricas suggested to the **Jovanovics that Roclin should lease The Plaza Hotel to the Jovanovics so that (as the Judge put it) "if the Bank sold the freehold, this lease would encumber the property". On 12 January 1995 a lease agreement with respect to the property was executed between Roclin as lessor and Mr Jovanovic (trading as Milan Investments) as lessee for a period of three years commencing on 15 January 1995 with rights of renewal and an annual rental of $96,000. At the trial, counsel for the Jovanovics** admitted that this document was (to use counsel's words) "a sham" and was executed for the purpose of possibly defeating the creditors of Roclin.

79. In November 1995, Roclin entered into a contract to sell the property to Fortson for the sum of $750,000. The Judge found that the contract was executed on 16 November 1995, although it is dated 12 October 1995. For the purposes of the appeal the difference is not material. Fortson was a shelf company purchased by the **Jovanovics** for the specific purpose of buying the property. The contract for sale and purchase provided that it was subject to a tenancy, and that the tenant was Entienee Pty Ltd. However, in a later provision in the contract it provided that the lease to Entienee Pty Ltd was to be extinguished prior to settlement. The contract excluded from the sale "All Tenant's goods, chattels, plant and equipment and stock in trade". To finance the purchase, Fortson borrowed the sum of $750,000 from the Bank. As I have said, the Bank obtained various forms of security in relation to the loan. In due course, settlement of the contract of sale and purchase occurred. The Judge found that the proposal which led to the contract evolved as a further attempt by the Govedaricas to defeat and defraud their creditors. The initial proposal involved the sum of $700,000. That figure was later increased to $750,000. The only other tender was from a family member who was involved in the arrangements.

80. On 15 November 1995, the **Jovanovics and the Govedaricas entered into an agreement whereby the Jovanovics agreed to hold two-thirds of the**

ownership and liabilities of the title to the property on trust for the Govedaricas (one-third each). The Judge referred to this agreement as "the secret agreement" and so will I. It is not entirely clear that this agreement encompasses the hotel business as well as the freehold title of the property, but for present purposes I will proceed on an assumption favourable to the Jovanovics' and Fortson, namely, that that was the intention of the parties at the time the agreement was executed.

81. On 8 July 1996, Fortson purported to enter into an agreement with MRM International Pty Ltd. I say "purported" because Mr **Jovanovic'** admitted that the document was a sham which had been drawn up for the purpose of representing to a financier that the tenancy was occupied.

82. After the purchase by Fortson in November 1995, the **Jovanovics continued to conduct a newsagency business on the property and it seems the Govedaricas (or an entity controlled by them), continued to conduct the hotel business. It seems that the Jovanovics could not gain access to the income stream generated by the hotel business, and it was not long before Fortson failed to make timely repayments of its loan to the Bank. The Jovanovics'** were in a desperate financial position by at least early 1997.

83. In October 1996, the Bank's officer, Ms Cindy Barker was given the file within the Bank and by 17 October 1996 she had recommended a strategy for the recovery of moneys then outstanding.

84. The contract of sale and purchase between the Bank and Roclin dated July 1997 specifically excludes from the sale, "all goods, chattels, plant equipment and machinery and moveable items not in the nature of permanent improvements in or about the Land", and attempts to qualify the Bank's obligation to give vacant possession at settlement.

85. The newsagency business failed in 1998 with large debts owing to various suppliers.

86. In his reasons for judgment, Gray J has summarised the important events which occurred between October 1996 and July 1997, and I gratefully adopt his summary of those events.

87. At this stage, it is convenient to mention some important points about the Judge's findings of fact in relation to the events which occurred between October 1996 and July 1997, and the extent to which those findings were challenged on appeal. First, the Judge accepted Ms Barker's evidence in its entirety, and said that where there was any divergence between the evidence of Mr **Jovanovic and that of Ms Barker, he had no difficulty in preferring the evidence of Ms Barker. That conclusion of the Judge was not seriously challenged by counsel for the Jovanovics'** and Fortson. In any event, there is no reason to disagree with the Judge's conclusion in that regard.

88. Second, although the Judge found that Mr Burton's valuation was a well reasoned document and its conclusion could not be criticised, and that the

Bank was entitled to act on the basis of the valuation, the Judge did not make a finding that Mr Burton's figure represented the market value of the freehold title of the property. In fact, the Judge did not make a finding as to the market value of the freehold title of the property. That was expressly accepted by counsel for the Bank during the course of submissions before this Court, and accords with my reading of the Judge's reasons for judgment.

89. Third, the Judge found that even by the time of trial, there was still (as the Judge put it), "great uncertainty as to the legal position of the persons who are either entitled to own or manage the business of the hotel, and that this issue will not be determined until litigation between the former partners is completed". The Judge said that much had been made of the value of the business of the hotel. However, he said that the Bank, no doubt on legal advice, excluded from the sale to Roclin in July 1997 any property associated with the business. I take the Judge to be saying that on the evidence it was not possible for the Bank in 1997 or, for that matter, the Judge at trial, to determine who owned or managed the hotel business. It seems that before the Judge counsel for the **Jovanovics and Fortson said that he did not challenge the conclusion that the Bank did not sell the hotel business. There was debate on the hearing of the appeal as to the precise nature of the concession made by counsel. Counsel for the Jovanovics and Fortson said that what in fact he was conceding was that the Bank did not purport to sell the business, but that in the circumstances, by selling the freehold title of the property, the Bank disposed of the business for no consideration. He submitted that in effect the Bank gave the business away. For reasons I will give, I have reached the conclusion that the Bank was not in breach of any duty it owed in relation to the hotel business, and therefore it is unnecessary for me to consider the nature of any concession in the court below, or whether, if it was a concession of the nature suggested by counsel for the Bank, the Jovanovics** and Fortson should now be permitted to change their position.

The Issues on Appeal

90. In order, I think the issues on appeal are as follows:

1 Did the Judge correctly identify the common law, equitable and statutory duties the Bank as mortgagee owed to Fortson as mortgagor and the **Jovanovics** as guarantors? If not, what is a correct statement of those duties?

2 In relation to the hotel business which the Bank purported to exclude from the sale to Roclin, was the Judge correct to conclude that the Bank did not act in breach of any of the duties it owed to Fortson and the **Jovanovics**?

3 In relation to the freehold title of the property which the Bank did sell, was the Judge correct to conclude that the Bank did not act in breach of any of the duties it owed to Fortson and the **Jovanovics**?

4 If no to question 3, are the **Jovanovics** entitled to recover from the Bank the loss of the value of the newsagency business?

5 If the Bank did act in breach of one or more of the duties it owed to Fortson and the **Jovanovics**, what is the nature of the relief to which those parties are entitled, and what orders should now be made by this Court?

The Duties owed by the Bank to Fortson and the Jovanovics

91. In exercising its power of sale, the Bank owed equitable duties to Fortson and the **Jovanovics. The Judge defined these duties as a duty to act in good faith, and a duty not to act with calculated indifference or reckless disregard of the rights of Fortson and the Jovanovics. There is authority that there is but one duty, namely a duty to act in good faith (Kennedy v De Trafford [1897] AC 180), and that as part of that duty the Bank must not act with calculated indifference or reckless disregard of the rights of Fortson. For convenience, I will refer to one duty being the duty to act in good faith. There is no doubt that in exercising its power of sale the Bank owed such a duty to Fortson (Pendlebury v Colonial Mutual Life Assurance Society Ltd (1912) 13 CLR 676; Citicorp Australia Ltd v McLoughney & Anor (1983) 35 SASR 375). The extent to which the equitable duty owed by a mortgagee to a mortgagor involves a duty to take reasonable steps to obtain the best possible price for the property has been the subject of considerable debate in the authorities. In Commercial and General Acceptance Ltd v Nixon (1982) 152 CLR 491, Gibbs CJ said the authorities were irreconcilable (at 494). However, it is unnecessary for me to examine that issue in this case, because it was common ground that the Bank owed the duty in s 420A of the Corporations Law, and I think it is right to say that the statutory duty is at least as extensive as the broadest formulation of the equitable duty. Although the issue was not the subject of submissions to this Court, it seems that the equitable duty the Bank owed to the Jovanovics as guarantors was more onerous than the equitable duty it owed to Fortson (Buckeridge v Mercantile Credits Ltd (1981) 147 CLR 654 per Brennan J (as he then was) at 675). However, the equitable duty owed by the Bank to the Jovanovics** as guarantors is no more onerous than the duty in s 420A (Westpac Banking Corporation v Kingsland (1991) 26 NSWLR 700) and as it is common ground that the Bank owed the duty in s 420A, it is unnecessary to discuss this issue any further.

92. The Judge appears to have rejected any suggestion that the Bank, in exercising its power of sale, owed a common law duty of care to take reasonable care to secure the best possible price for the property. I think the Judge was right to take this approach. In my respectful opinion, the weight of authority in this country is that a mortgagee exercising a power of sale does not owe a common law duty of care (Pendlebury v Colonial Mutual Life Assurance Society Ltd (supra); Citicorp Australia Ltd v McLoughney (supra); Westpac Banking Corporation v Kingsland (supra); GE Capital Australia v Davis & Ors [2002] NSWSC 1146). In view of the fact that it was common ground that the Bank owed the duty in s 420A, the issue is of little practical significance in this case

in terms of the content of the Bank's duties. However, it is relevant to the question of the appropriate remedies. In my opinion, neither Fortson nor the **Jovanovics** are able to claim damages at common law against the Bank.

93. The Judge referred to the duty specified in s 420A of the Corporations Law. At the relevant time, that section read as follows:

> "(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 possible price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.
>
> (2) Nothing in subsection (1) limits the generality of anything in section 232."

94. Neither party suggested that the property in question did not have a market value, and in those circumstances I am able to concentrate on s 420A(1)(a).

95. The Judge discussed the scope of the section briefly. He noted correctly that the section does not stipulate a correct method of sale. He referred to the decision of Campbell J in Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd [2002] NSWSC 16, and noted that in that case it was said that in deciding whether there has been a breach of the section the Court will look at the process the holder of the power goes through in selling the property. That is no doubt correct. The market value may be a relevant item of evidence on the question of whether there has been a breach of duty, but it is by no means decisive. It may be possible, although I would have thought fairly rare, that a controller would take all reasonable care to sell the property for not less than market value, and yet, for some reason outside his or her control, not obtain not less than market value. It is certainly possible that a controller might not take all reasonable care to sell the property for not less than market value and yet be fortunate enough to obtain market value. In that situation, those to whom the duty is owed may establish a breach of duty but no entitlement to relief.

96. In the context of his discussion of s 420A of the Corporations Law, the Judge referred to a passage in Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd (supra) that suggested that the relevant question in determining breach of duty was whether "any departure from reasonable standards [was] so serious as to be properly characterised as unconscionable, in order to render the mortgagee accountable". However, that comment was made by Campbell J in the context of a discussion of the relevant equitable duty, not the duty in s 420A. The Judge erred insofar as he said that it was the relevant question for the purposes of s 420A. The relevant question for the

purposes of s 420A is whether the controller has taken all reasonable care to sell the property for not less than its market value and that in turn involves a consideration of whether the controller:

> "has failed to do what a reasonable and prudent person would do, or has done what a reasonable or prudent person would refrain from doing in the circumstances".

(Commercial and General Acceptance v Nixon (supra) per Mason J (as he then was) at 501).

The Alleged Failure to sell the Business

97. It was common ground that the Bank purported to exclude the hotel business from the sale of the freehold title of the property.

98. There is an argument which was advanced by the **Jovanovics and Fortson which I should mention at the outset. The Jovanovics and Fortson argued that in its Defence to Counterclaim, the Bank admitted that Fortson purchased the hotel business in 1995 and that it disposed of the hotel business in 1997. It was argued that the Judge erred in allowing the Bank to amend its Defence to Counterclaim after the hearing to withdraw such admissions. It does appear that the Bank's Defence to Second Amended Counterclaim, which was filed after the hearing, withdrew certain admissions about the hotel business. However, these matters were raised in correspondence sent to the Judge. The Judge decided to let the Defence to Second Amended Counterclaim stand, and I am not satisfied that he erred in doing so. The Judge had a discretion which he exercised and there are no grounds upon which this Court should interfere with the exercise of the discretion. I am not satisfied that the Jovanovics** or Fortson would have, or may well have, conducted their case differently had the Defence to the Second Amended Counterclaim been filed before the hearing.

99. The challenge by counsel for the **Jovanovics and Fortson to the Judge's conclusion that the Bank did not act in breach of duty in relation to the hotel business rested on two propositions. To succeed on this issue the Jovanovics** and Fortson must make good both propositions. First, they must establish that Fortson was the owner of the hotel business in July 1997 either in law and equity, or at least in law. Second, they must establish that the Bank could not sell the freehold of the property without at the same time selling the business, and its attempt to do so resulted in the loss of the business, or its disposal for no consideration.

100. As to the first proposition, counsel for the **Jovanovics** and Fortson submitted that the sale of the property by Roclin to Fortson in November 1995 included the sale of the hotel business. Counsel submitted that whatever might have been the position in equity as a result of the secret agreement dated 15 November 1995 or subsequent dealings, Fortson was and remained the legal owner of the hotel business and was entitled to complain about the action the

Bank took, or failed to take, when it exercised the power of sale in July 1997. In the ordinary case, there would be force in this submission. However, in this case there was a pervading air of fraud and deception.

101. As I have already said, the Judge found that there was great uncertainty as to the legal position of the persons who are entitled to own or manage the business of the hotel, and that that issue would not be determined until litigation between the **Jovanovics and the Govedaricas is completed. The Judge was unable to make a finding on the balance of probabilities that the hotel business was owned by Fortson or the Jovanovics. It is true that he did not make a finding that the hotel business was owned by some other party, but the onus was on Fortson to establish that it owned the hotel business either in law and equity, or at least in law. I do not think the Judge erred in not being satisfied of this fact. The Judge found that from 1995 onwards the Jovanovics and the Govedaricas engaged in a devious web that perhaps could also be viewed as fraudulent conduct to defeat their creditors and for the purpose of retaining the ownership of The Plaza Hotel. That finding was amply justified on the evidence. The lease agreement between Roclin and Mr Jovanovic executed on 12 January 1995 was "a sham" and was entered into for the purpose of possibly defeating the creditors of Roclin. The secret agreement between the Jovanovics and the Govedaricas dated 15 November 1995 was not disclosed to the Bank by the Jovanovics until some considerable time after it had been entered into. It was obviously an important and material fact, and the Judge noted Ms Barker's evidence that had the Bank known of the agreement, it may not have made the loan in the terms it did to Fortson. The contract whereby Fortson purchased the property from Roclin in November 1995 evolved as a further attempt by the Govedaricas to defeat and defraud their creditors. The scope of the exclusion in relation to tenants' goods and chattels is not entirely clear. The agreement between Fortson and MRM International Pty Ltd dated 8 July was a sham which was drawn up for the purpose of representing to a financier that the tenancy was occupied. After November 1995 the Govedaricas and, in particular, Mr Slavko Govedarica, continued to conduct the hotel business as they had done before that date. This continued and was the position in July 1997. As I understand it, during this period, the Jovanovics** conducted the newsagency business and played no part in the management or operation of the hotel business. The accountants, Ernst and Young, engaged by the Bank at the time to clarify who held the operating rights for the hotel business said that until they received certain documentation they were unable to state with certainty who held the operating rights for the hotel business. When one adds to these matters the fact that the expert accountancy evidence called at trial did not provide a secure basis for a positive finding, I do not think the Judge erred in not being satisfied that Fortson owned the hotel business.

102. Absent such a positive finding of ownership, neither Fortson nor the **Jovanovics** can complain of any action the Bank took, or failed to take, in relation to the hotel business. Furthermore, absent such a positive finding of ownership it is simply not possible to say what the Bank would have

discovered had it taken the further action before sale suggested during the course of argument before this Court, such as appointing a receiver or seeking an order for possession.

103. In case I am wrong as to the first proposition, I make some observations as to the second proposition. It is clear that there has been a long running dispute between the Jovanovics and the Govedaricas about the **commercial relations between them and their respective entitlements to the property, including the hotel business. Even if the Bank had appointed a receiver or sought an order for possession prior to sale, the question of who owned the hotel business may not have been resolved in a way that would have enabled the Bank to realise its security in a timely fashion. The Bank had already taken steps to clarify the position as to the ownership of the hotel business and had been unable to do so. More importantly, even if Fortson did own the hotel business, it is not at all clear on the evidence that the Bank's conduct in selling the freehold title of the property to the Govedaricas and purporting to exclude the hotel business from the sale has led to the loss of the hotel business by Fortson. The contract between the Bank and Roclin excluded all goods and chattels from the sale, and attempted to qualify the Bank's obligation to give vacant possession at settlement. On the face of it, the fact that the freehold title of the property was sold to Roclin (the Govedaricas), rather than an independent third party means that the rights of Fortson and the Jovanovics in relation to the hotel business are not lost and can be asserted against Roclin and the Govedaricas. As I understand it, the issue of the ownership of the hotel business and the entitlement to the profits of the business is the subject of the litigation between the Jovanovics** and the Govedaricas.

104. The Bank did not act in breach of duty in relation to the hotel business conducted on the property at the time of sale.

The Alleged Breach of Duty by the Bank in relation to the Sale of the Freehold Title of the Property

105. The Judge asked himself whether the Bank had acted in breach of the equitable duty as he identified it. Perhaps because he considered that the test is the same or at least similar in the case of the statutory duty as it is in the case of the equitable duty, the Judge did not ask himself whether the Bank had acted in breach of the statutory duty in s 420A. In my respectful opinion, he erred in failing to do so.

106. In his reasons for judgment, Gray J has identified a number of matters which have led him to the conclusion that the Bank did act in breach of the duty in s 420A. I disagree with Gray J in relation to one matter. Subject to that matter and the following observations, I respectfully agree with his Honour's analysis and with his conclusion.

107. I do not agree with Gray J that the Bank's approach to the ownership and sale of the hotel business can be criticised, and I would exclude it as a

reason for concluding that the Bank acted in breach of the duty in s 420A. I refer to the reasons I have already given.

108. As to the recommendations made by Ernst and Young, I would emphasise the fact that the Bank did not appoint an agent and put the property to the market (an option identified by Ernst and Young) in circumstances in which it should have, rather than the fact that they did not follow the advice of Ernst and Young.

109. It is impossible not to have some sympathy for the position the Bank found itself in. It was the **Jovanovics and the Govedaricas who were pressing the Bank to adopt the closed tender process which it eventually did. Although it made a number of inquiries, the Bank could not identify the party which held the operating rights to the hotel business, nor, it seems, could it obtain reliable trading figures for the business. The parties in the best position to know of these matters were the Jovanovics and the Govedaricas. The lack of reliable trading figures would make it difficult to market the business. Furthermore, it was Mr Jovanovic who was assuring the Bank that he could secure the necessary finance. As against those matters, the Bank was aware before the sale that the Jovanovics** were not in a position to secure the necessary finance from an independent source. In addition, the closed tender process involving two bidders was far removed from the Bank's usual practice in exercising a power of sale. In my opinion, it was encumbent on the Bank to appoint an agent, conduct a proper marketing campaign and put the property to the market, rather than accept and provide the finance for one bid when the only other bid was from a person the Bank knew could not raise the necessary finance from an independent source. The valuation of Mr Burton was not enough to justify the course taken by the Bank, particularly in light of the differences between Mr Burton's valuation and the Bank's internal valuation. In my opinion, the Bank did not take all reasonable care to sell the freehold title of the property for not less than its market value within the terms of s 420A of the Corporations Law.

The Loss of the Newsagency Business

110. The Judge found that Mr **Jovanovic was obliged to close the newsagency business in 1998, and that at that time there were large debts owed to various suppliers. The Jovanovics** argued that they would have been able to sustain the newsagency business with funds which would have been available to them if the Bank had obtained the market value for the property within the terms of s 420A. They claimed that the value of the business was $75,981 and they sought this amount from the Bank.

111. The Bank on the other hand, referred to the Judge's finding that the **Jovanovics** were in a desperate financial position by no later than early 1997 and argued that this was the reason the newsagency business failed.

112. The newsagency business was owned by the **Jovanovics, not Fortson. Although the Bank owed a duty to the Jovanovics in their capacity as guarantors, I do not think that in selling Fortson's property**

the Bank owed a duty to the Jovanovics' as owners of the newsagency business. In this respect, they were in effect third parties.

113. The claim by the **'Jovanovics'** for the loss of the newsagency business must fail.

The Nature of the Relief to which Fortson and the 'Jovanovics' are entitled and the orders which should be made by this Court

114. I said earlier in these reasons that the Bank did not owe a common law duty of care to Fortson or the **'Jovanovics'** and neither has a claim against the Bank for damages at common law. For breach of the equitable duties in relation to the exercise of the power of sale, a mortgagor would be entitled, on the taking of accounts between mortgagee and mortgagor, to have brought to account the loss it has suffered. Guarantors would be entitled to an equitable set off in relation to any claim on the guarantee to the extent of the loss caused by the mortgagee's breach of duty. Guarantors are entitled to no more than a set off of the claim on the guarantee. They are not entitled to make a counterclaim.

115. I have found that the Judge erred in finding that the Bank did not act in breach of the duty in s 420A. In those circumstances, a question arises as to whether s 420A merely adds to the duties the Bank was under, or whether it does that and provides an additional remedy to Fortson and/or the **'Jovanovics'**. This issue was considered by Bryson J in GE Capital Australia v Davis & Ors (supra) and his Honour decided that s 420A does not provide an additional remedy. I respectfully agree with his Honour's analysis. Bryson J noted that the Corporations Law did not provide a remedy for a breach of the duty in s 420A. Section 1324(10) of the Law could not be relied upon because at the time the action was commenced there was no prospect an injunction would be granted (see also Executor Trustee Australia Ltd v Deloitte Haskins & Sells (1996) 135 FLR 314). Furthermore, there was nothing in the section or elsewhere in the Law which suggested that it was enacted for the benefit of persons who do not have an interest in the corporation's property. Bryson J referred to the authorities which deal with the question of the circumstances in which an individual has a remedy in damages for breach of a statutory duty.

116. Bryson J expressed his conclusions as follows (at [53], [54] and [56]):

> "My view is that the requirement imposed on the controller by subsection 420A(1) takes the place of, or it may be operates cumulatively to the obligation otherwise existing with the general law of a controller exercising power of sale in respect of property of a corporation. In so doing the section enhances the duty of the controller and the protection afforded to the corporation. This is achieved, and the apparent legislative intention is fulfilled without altering the remedies available to the corporation for breach of obligation in exercising the power of sale, and without

altering the means available for obtaining remedies. Where real property subject to a mortgage has been sold and the mortgagor succeeds in establishing that there has been a sacrifice of the mortgagor's interest in the exercise of the power of sale the mortgagor's remedy is to be credited compensation when accounts are taken of the mortgage debt. Subsection 420A(1) alters this scheme by inserting a more stringent rule, but does not otherwise change the scheme.

Section 420A can readily be given full and effectual operation without resorting to any implication of an intention to confer a remedy in damages on corporations which mortgage their property, still less to confer such a remedy on guarantors of the debts of those corporations; section 420A can readily take a place in the existing remedies without supposing that it was intended to confer or that it does confer any rights at all upon guarantors.

...

In my view there is nothing to indicate that it was the intention of the legislature that subsection 420A(1) should confer any right or remedy on guarantors or other persons who involve themselves contractually in consequences of the exercise of the power of sale, but the guarantor is entitled to rely on the availability to the mortgagor of a remedy, whether the remedy was that previously established by Pendlebury v Colonial Mutual Life Assurance Society Ltd (1912) 13 CLR 676 or is now the remedy available to the mortgagor on breach of the duty declared by subsection 420A(1); the guarantor is entitled to have an equitable remedy on the basis that the mortgage accounts are taken on whatever may be the principle truly applicable to taking mortgage accounts. In my opinion the equitable remedies which in an earlier state of the law were available to a guarantor where there was a breach of the mortgagee's duty to a mortgagor corporation are now to be tested by reference to whether there was a breach of the duty stated in subsection 420A(1)."

117. The question remains as to the price which would have been obtained for the freehold title of the property had the Bank taken all reasonable care in terms of the section. In the circumstances of this case that involved appointing an agent, conducting a proper marketing campaign and putting the freehold title of the property to the market. The difference between the price which would have been obtained had that been done and the price the Bank in fact obtained, together with appropriate adjustments in relation to the expenses of

the sale, is the measure of the loss for the breach of the duty in s 420A. Unfortunately, this Court is not in a position to determine that figure. It involves an assessment of the valuation evidence including an assessment of the extent to which that precise issue has been addressed by the valuers, and a determination as to the valuation evidence which should be preferred. It may be noted that the market value as defined by one or more of the valuers who gave evidence is not necessarily the same as the sale price that would have been achieved had the Bank appointed an agent, conducted a proper marketing campaign and put the freehold title of the property to the market.

118. The question which I have identified must be determined by the Judge and it will be a matter for him whether, if the parties wish to call further evidence, he allows that to be done. If the conclusion is reached that there is a difference, then Fortson is entitled to have the difference brought to account in the taking of accounts between it and the Bank. Depending on the figure, it may or may not have a counterclaim. The **Jovanovics are entitled to bring to account by way of an equitable set off to the claim on the guarantee the difference, if there be a difference. As guarantors they are not entitled to bring a counterclaim, and although they were directors and shareholders of Fortson, they are not entitled to claim for loss sustained by the company (Gould v Vaggelas (1985) 157 CLR 215). For these reasons, I disagree with the conclusion of Gray J that the Jovanovics** are entitled to pursue their counterclaim against the Bank.

Conclusions

119. I would make the following orders:

1 The appeal is allowed.

2 The orders of the Judge made on 13 June 2003 are set aside.

3 The action is remitted to the Judge for the hearing and determination (including the making of any necessary orders) of the issue identified in the above reasons.

120. I would hear the parties on the question of whether any other orders are appropriate, and on the question of the costs of the appeal.

JUDGMENT CITATIONS LISTED IN ORDER OF APPEARANCE IN JUDGMENT

1 It was accepted by counsel for the bank that the bank was a controller within the meaning of the Act.

2 ALRC, *General Insolvency Inquiry,* Report No 45 (1988) [236] (commonly referred to as the Harmer Report)

3 [1976] VR 309 at 312

4 77(1) If within one month after the service of such notice or demand or such other period as is fixed in such mortgage or charge the mortgagor grantor or other persons do not comply with the notice or demand the mortgagee or annuitant may, in good faith and having regard to the interests of the mortgagor grantor or other persons, sell or concur with any other person in selling the mortgaged or charged land or any part thereof, together or in lots, by public auction or by private contract ...

5 (1982-1983) 152 CLR 491

6 (1982-1983) 152 CLR 491 at 503

7 (1982-1983) 152 CLR 491 at 491 at 515

8 (1982-1983) 152 CLR 491 at 524

9 [2002] NSWSC 16 at [126]

10 (1983) 152 CLR 491 at 522-523

11 [2002] NSWSC 1146 at [45]

12 (1937) 58 CLR 710 at 738

13 (1981) 147 CLR 654 at 675

14 [2002] NSWSC 1146 at [92]

15 [1982] 3 All ER 938 at 942

16 (1982-1983) 152 CLR 491 at 525 (per Brennan J)

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[1] It was accepted by counsel for the bank that the bank was a controller within the meaning of the Act.

[2] ALRC, *General Insolvency Inquiry,* Report No 45 (1988) [236] (commonly referred to as the Harmer Report). See also [164].

[3] [1976] VR 309 at 312

> [4] 77(1) If within one month after the service of such notice or demand or such other period as is fixed in such mortgage or charge the mortgagor grantor or other persons do not comply with the notice or demand the mortgagee or annuitant may, in good faith and having regard to the interests of the mortgagor grantor or other persons, sell or concur with any other person in selling the mortgaged or charged land or any part thereof,

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