

# When is it bad to throw out your litter?

Monday, 19 April, 2004



**Along with being a timely reminder of the responsibility of a mortgagee when selling a mortgagor's property, this case study by Stephen Mullette, (left) Associate, The Argyle Partnership, is a salutary tale of how one person's pile of manure can be another person's agricultural investment.**

*Hadfield v Commonwealth Bank of Australia Limited (2002) 1 DCLR (NSW) 41*

It was a standard sale of rural property by a mortgagee bank. It took more than two years to get the property sold, in which time the bank had become caught up in various Family Law and injunction proceedings. The bank was no doubt pleased to see the sale finally go through.

But the bank was cautious. It knew that it had to sell the property for the proper value. It scheduled a public auction. It got valuations. Lots of them. The valuations ranged between \$250,000 to \$310,000 for the property. There was some suggestion that if the property was subdivided it might obtain a better price. The usual story. The mortgagor kept on talking about it, but the simple fact was that no subdivision had been registered and the bank did not want to spend the money. The bank decided to sell the property without subdividing it. Bearing in mind the valuations, it set a reserve for the auction of \$310,000, but in the event that the reserve was not reached, it gave the auctioneer power to negotiate down to a figure of \$280,000.

The property sold for \$285,000. This was in the middle of the valuations, and was a figure obtained from a public auction of the property after a normal marketing period. This left a shortfall of around \$37,717.87 owing to the bank. The Plaintiff did not pay this amount to the bank.

Surely the Plaintiff was crazy, taking on a bank in these circumstances.

Almost nine years later, and nearly 11 years after his last payment on the mortgage, the District Court ordered the bank to pay the Plaintiff mortgagor almost half a million dollars, plus interest and costs.

How could such a simple matter have gone so horribly wrong?

District Court Judge Balla found the bank had:

1. breached its duty of good faith to the mortgagor in not subdividing the property;
2. breached its duty of good faith to the mortgagor in the description of the property during the advertising campaign prior to auction; and
3. sold the property without letting the mortgagor collect some personal property.

## Subdivision of the Property

The starting point was the good faith test in *Pendlebury v Colonial Mutual Life Assurance Society Ltd* (1912) 13 CLR 676 where *Griffiths* CJ held (at 680, 681) that:

"... the mortgagee must not recklessly or wilfully sacrifice the interests of the mortgagor, and that if he does he is to be taken as not having acted in good faith."

The question was whether the bank had "absolutely disregarded the interests of the mortgagor" (ibid).

*Balla* DCJ found in this case the mortgagor had drawn up his plans and taken the subdivision of his land to council. Consent of council "could have been obtained in two days if the council accepted that there were circumstances of urgency" (at 71). The judge also held the Plaintiff mortgagor would have attended to obtaining the subdivision promptly if only the bank had consented. The subdivision could have been completed before the first advertisement for the property was placed, and the only expense still to be incurred in obtaining the subdivision was the registration fee of around \$500.

This amount, and attending to registration of the subdivision, was held by *Balla* DCJ to be "an amount appropriate to prevent the residual property being sacrificed" (Pendlebury (at 701)) (at 72).

Therefore His Honour found the bank had breached its duty to act in good faith in not consenting to and assisting the Plaintiff to effect the subdivision.

## **Advertising the Property**

### **Size of the Property**

In the course of preparing the plans for subdivision, the surveyor had noticed that the property was actually substantially bigger than had been thought. Instead of 23 acres, the property was in fact 32 acres. The bank put a special condition in the property that the purchaser would not make any claim in relation to this fact.

However the Judge held that the bank had a positive duty to bring the actual size of the property to the attention of potential purchasers when the property was advertised for sale. The reference in the advertising material to the lower figure was a "material misdescription" which caused the pool of potential purchasers to be reduced (at 76). This was a breach of the bank's duty of good faith to the mortgagor.

### **Use of the Property**

In addition, in advertising the property for sale the bank had omitted to mention that the property had been operated as a goat dairy, and a turf farm, amongst other agricultural pursuits of the mortgagor.

Again, this failure was a breach of the duty of good faith owed by the bank to the mortgagor.

## **Chattel Claim**

Finally, the bank had disposed of the property without letting the mortgagor collect one of his belongings. What was that item? Well as it happened it was around 284 tonnes of organic waste and manure, somewhat euphemistically described as "deep litter". In amongst the deep litter were also approximately 20 tonnes of worms, who consumed the deep litter to make "vermi-compost" a substance of some value as a fertiliser etc. The mortgagor had never collected or sold any however.

How had the bank missed this thriving agricultural industry? The deep litter was piled a metre high in two sheds. However these were the two sheds which were used for feeding the goats, who would climb onto the worm farm and eat hay from hangers overhead. The manure from the goats was mixed with hay to form food for the worms.

The next question the bank asked was how on earth the mortgagor could own any property in worms which could crawl into the ground or away from the sheds. It argued that there is no legal property in a wild animal, unless it has been captured or is otherwise unable to get away. The Court decided however that the proper analogy was with a swarm of bees and that there was authority that (at 79):

"a swarm of bees once hived becomes property which continues so long as the hiver can see them." (*Quandrill v. Spragge* (1907) 71 JP 425)

Therefore the Court held that the mortgagor had acquired property in the worms.

Finally, the bank argued, if there was 284 tonnes of organic waste which had been trampled into the ground by a flock of goats, surely this must mean that the worm farm was a fixture, forming part of the land and able to be sold by the bank? If anything the vermi-compost was analogous to a crop, or "chattels vegetable" which until severed from the land is a fixture. The Court disagreed that the produce of the worm's digestive system could ever be compared to growing vegetables. Further, the Court held that there was a layer of sand which had been put down prior to the first 50kg of worms being farmed. The deep litter was not attached to the ground and was thus not a fixture. The intention of the mortgagor was a relevant factor and the Court was satisfied that the worm farm "was established for his own enjoyment" (at 80).

The Court held that the bank had an obligation to hold the worm farm on behalf of the mortgagor as bailee, and had breached its obligation of "reasonable care" to the mortgagor (at 82). The bank was found liable in conversion and was ordered to pay damages.

## Conclusion

The bank was ordered to pay the difference between the sale price and the real value of the (subdivided) property. With some adjustments this amounted to approximately \$165,982 even after taking into account the amount the mortgagor still owed to the bank.

The bank was also ordered to pay the value of the "vermi-compost" which was found to be \$200,000, as well as the value of the worms -- \$71,000.

The total bill to the bank therefore was \$436,982, plus interest and costs.

This is a timely reminder of the responsibility of a mortgagee when selling a mortgagor's property. The usual elements were there -- inadequate advertising, misdescriptions and omissions in the sale process. However there is also the valuable lesson that a mortgagee may need to spend money to improve the property to obtain a better price at auction.

And of course, there is the salutary tale that one person's pile of manure is another person's

agricultural investment. Next time you stumble over a metre high pile of "deep litter" be careful you aren't too hasty in "keeping Australia clean".

(CCH Email Alert 19 April 2004)