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May 2011 Newsletter

>> LEASING PROPERTY PRIOR TO SALE

A borrower hoped to lease a commercial property to get a higher price in the sale...

When must a financier consent to such a lease...

In May 2008, Lucia Paola and Maria Paola borrowed \$2.4 million from Challenger. As security for the loan they gave a mortgage over a commercial property on Pittwater Road, North Narrabeen.

In July 2009, Mr and Mrs Paola defaulted on the loan and Challenger started proceedings in September 2009 to recover the money owing.

Judgement was entered in December 2009.

Mr and Mrs Paola applied to the court and successfully obtained a number of stays of the writ of possession.

In August 2010, they again approached the court for a further stay. They sought to set aside the default judgement and asked for an order to restrain the selling of their property until the lender consented to a number of leases. Mr and Mrs Paola argued that if the property was fully tenanted the value would be \$3,125,000.00 rather than \$2,392,306.00.

In December 2009 the solicitor for Mr and Mrs Paola wrote to the solicitors for Perpetual (the trustee of the lender) seeking consent to the leases. Perpetual, through its solicitors, sought details of the leases. In particular, they wanted:

- Copies of the proposed leases
- Copies of any development applications in respect of the property's subdivision
- Details of any proposals otherwise to subdivide the property prior of the registration of the leases
- Copies of any other documents in respect of the proposed leases and subdivision of the property; and
- An updated valuation to be conducted on the property to enable a determination of the cross claimant's lease proposal.

Mr and Mrs Paola responded by saying that they had not prepared the leases and would not do so until an approval had been given and that the subdivision would not be affected by way of a registered deposited plan and that no further documentation is available.

Perpetual decided that their security was at risk by further delaying and refused to consent to the leases.

Mr and Mrs Paola submitted to the court the following matters:

- That it was an implied term of the mortgage that Perpetual would not take any step that would have the effect of reducing the value of the property
- That it was an implied term of the mortgage that Perpetual would not unreasonably withhold its consent to the registration of any leasehold interest in the property
- That Perpetual owes an equitable duty and an implied contractual duty to do any act which is reasonable and which will help obtain the best price for the property upon the sale by the mortgagee.

After considering the law and all of the facts, His Honour decided that it is perfectly legitimate for Perpetual to refuse to consent to the leases and allowed the Sheriff to proceed with taking possession so that the property could be sold to repay the debt.

The lesson to be learnt in this case is that if such an argument is to be advanced there should be careful consideration of the facts to ensure that it can be established that the lender is acting unreasonably in refusing consent.



The articles contained in this newsletter are in the nature of general comment only. The articles are neither intended nor should be taken to be, advice in respect of any particular matter. Advice should be sought in relation to particular circumstances.

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>> GUARANTOR CONTRIBUTIONS

If a guarantor pays out a debt that is guaranteed that guarantor can seek contribution from other guarantors...

In some circumstance a guarantor cannot seek contribution from a co guarantor...

In May 1977, Mr Nicholas Friend and Mr Frederick Brooker set up an engineering business, Friend and Brooker Pty Ltd. The company was financed partly by personal borrowings from Mr Friend, Mr Brooker, their families and friends. In November 1986, Mr Brooker borrowed \$350,000.00 from SMK Investments Pty Ltd which was secured by mortgages over two properties in which Mr Brooker had an interest. The funds were largely used to pay three creditors of the company. The relationship between Mr Friend and Mr Brooker deteriorated because of a disagreement about the use of funds to repay the loan that Mr Brooker had secured from SMK Investments Pty Ltd.

Mr Brooker commenced proceedings against Mr Friend in the Supreme Court of New South Wales claiming that a partnership or joint venture had existed between them between 1977 and 1995. Mr Brooker claimed that the company was the corporate vehicle of the partnership or joint venture.

Before Justice Nicholas, Mr Friend was successful. In the Court of Appeal, Mr Brooker was successful and an order was made that Mr Friend should make contribution in relation to the loan from SMK Investments Pty Ltd.

The High Court reversed the Court of Appeal decision and held that no contribution need be made.

The High Court Judges made it clear that simply because some benefit is received, that is not enough to establish an obligation to contribute.

Brooker and Friend Pty Ltd secured a contract with the Eurobodalla Shire Council in January 1984. There were disputes and the contract price, in excess of \$2 million, was not paid. In November 1986, SMK Investments Pty Ltd agreed to lend \$350,000.00 to Mr Brooker. The director of SMK Investments Pty Ltd was Mr Graham Peterson. That gentleman gave evidence that he regarded his company as having rights against Mr Brooker not Mr Friend or their company. In cross examination Mr Peterson said that he was not going after Mr Brooker because they were friends and he was not interested in throwing him out of his house.

The High Court Judges quoted Judge Nicholas in his finding that there was no evidence that Mr Friend had agreed to be jointly liable for or contribute to the repayment of the loan from SMK Investments Pty Ltd.

When settlement monies were eventually received from the Eurobodalla Shire Council in September 1994, Mr Brooker claimed that the SMK Investments Pty Ltd loan had been made jointly for him and Mr Friend and that Mr Friend was also liable for the SMK Investments Pty Ltd loan. Mr Brooker claimed that he had paid \$575,000.00 to SMK Investments Pty Ltd and that Mr Friend should make a contribution towards the debt.

The High Court held that there was no obligation on Mr Friend to contribute to the repayment of the loan secured by Mr Brooker from SMK Investments Pty Ltd. SMK Investments Pty Ltd had not contracted with Mr Friend and Mr Brooker had not contracted with SMK Investments Pty Ltd as trustee for himself and Mr Friend.

Mr Brooker claimed that contribution should be ordered on the basis of a common design between himself and Mr Friend.

It was claimed that contribution should be enforced where a party seeking it has, by reason of and in reliance on a common design with the party from whom contribution is sought, undertaken a risk or expense which:

- a. was undertaken with the knowledge and ascent of that other party:
- b. was undertaken in order to effectuate or facilitate the common purpose or benefit which was the object of their common design:
- c. in light of the parties relationship and their common design, could not fairly be expected to be born as a burden alone by the party undertaking it:
- d. and there is no contract to the contrary.

The Judges held that this was not the law in Australia and could not succeed.

Mr Brooker totally failed in claiming that Mr Friend should contribute towards the repayment of the loan that he had obtained from SMK Investments Pty Ltd.